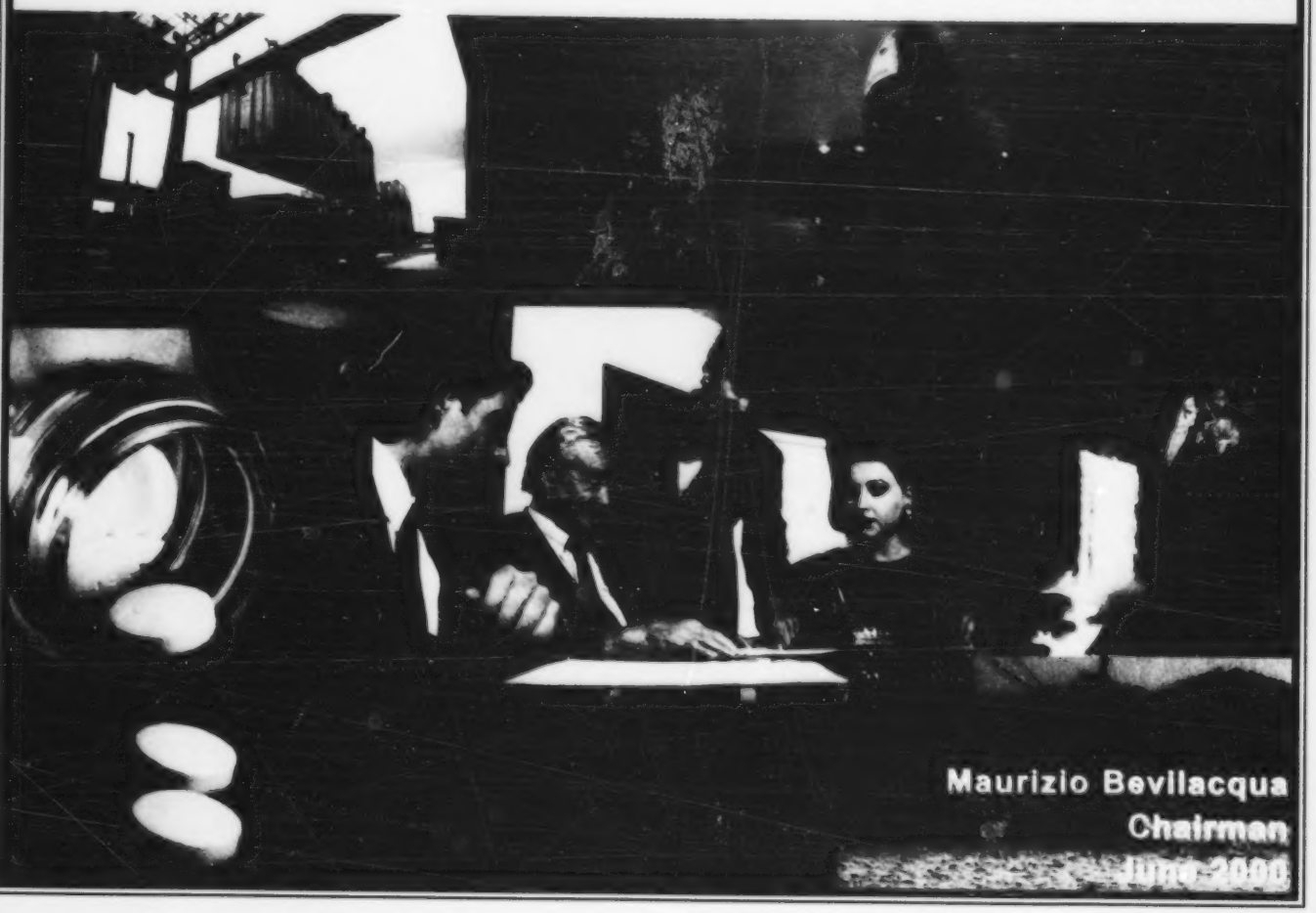
HOUSE OF COMMONS
CANADA

CHALLENGE FOR CHANGE

A Study of Cost Recovery

REPORT OF THE STANDING COMMITTEE ON FINANCE



Maurizio Bevilacqua
Chairman

June 2000

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CHALLENGE FOR CHANGE

A STUDY OF COST RECOVERY

Report of the
Standing Committee on Finance

Maurizio Bevilacqua, M.P.
Chairman

June 2000

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THE STANDING COMMITTEE ON FINANCE

has the honour to present its

NINTH REPORT

In accordance with its mandate under Standing Order 108(2), your Committee has studied Cost Recovery and has agreed to report the following:

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INTRODUCTION

In 1994, the government made cost recovery a priority for departments and government agencies. This initiative was undertaken in conjunction with spending cutbacks designed to eliminate the deficit, as well as Program Review, which was designed to deliver better and more appropriate government programs. As a result, fees were introduced for many services previously provided to individuals and businesses at no cost. These user fees were implemented not only to provide an alternate means of program funding, but more importantly to make government more efficient: to "get government right." According to University of Toronto Professor of Economics Richard Bird, user fees are important tools for government, not because they generate revenues but because they provide important signals to service providers about the demand for those services. Because of this, they help improve economic efficiency.

The current Cost Recovery and Charging Policy[1] was put into place in April 1997. It sets out a number of major principles for departments and agencies to apply when setting up user charges, e.g. that user charges should not only generate revenue, but improve services and focus them more on clients' needs.

Since the implementation of this policy, dissatisfaction has only increased. In its 1999 Pre-Budget Consultation report, this Committee noted growing concerns surrounding the government's cost-recovery program and the manner in which it is being followed:

> According to the Business Coalition on Cost Recovery (BCCR), these fees are more like taxes than prices for services. They appear to be subsidizing other activities or adding to general revenues. They are more like taxes because government departments are not following the guidelines originally set out in the Cost Recovery Program. They are not linking the charges to the value of services provided. They are not minimizing their costs of delivering services and they are not re-engineering themselves to provide better services. Indeed, in some cases such as veterinary drug approvals, service quality has deteriorated and is far from promised standards.
>
> As taxes, these user charges impose upon the economy the same kinds of distortions as do personal and corporate taxes. ... The introduction of new products in Canada is being delayed, imposing direct costs on consumers and causing our economy to be less productive.[2]

The introduction of new products in Canada is being delayed, imposing direct costs on consumers and causing our economy to be less productive.

Standing Committee on Finance, *Budget 2000: New Era, New Plan*

The Office of the Auditor General (OAG) has also highlighted problems with user charges on several occasions. Its December 1997 report commented that "recent audits by our office have highlighted weaknesses in the

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[1] Available at http://www.tbs-sct.gc.ca/Pubs_pol/opepubs/TB_h/crp_e.html.

[2] House of Commons Standing Committee on Finance, *Budget 2000: New Era, New Plan*, (Pre-Budget Consultations), December 1999, Chapter 6.

implementation of user charges. For example, we have found that government accounting systems are typically not designed to provide costing information needed to justify the levels of user fees charged."[3]

More recently, the OAG has criticized Agriculture and Agri-Food Canada for its failure to implement fully the Treasury Board policy. Specifically, it found that impact assessments (covering both costs and benefits) were incomplete, service standards were not widely used and that reviews of performance were largely absent.

The Committee, in hearings with department officials and industry groups, among others, examined two basic questions: Is the Cost Recovery and Charging Policy being implemented consistently across the government? And, is the policy itself sound?

The Committee's hearings confirmed the sentiments expressed in its 1999 Pre-Budget Consultations report. While the Policy itself generally conforms to sound economic practices, it is not being implemented consistently across government departments. Though flawed implementation in the various departments and agencies clearly play a role, there is also a problem stemming from a lack of effective direction from Treasury Board, which is responsible for the Policy. Central supervision, and dispute resolution, have proven to be ineffective or absent: departments have been left to their own devices in designing and implementing user charges.

I know that many observers have criticized the way user charges have been implemented and that our audit work over the years supports many of those criticisms.

Denis Desautels,
Auditor General of Canada

As the Auditor General, Denis Desautels, told this Committee: "I know that many observers have criticized the way user charges have been implemented and that our audit work over the years supports many of those criticisms." This should not be completely surprising. Richard Bird, a noted Canadian public finance expert, told the Committee that it is easy to design a tax system but hard to implement it. With respect to user fees, it is difficult just to design a system.

This study is divided into two parts. The first examines the Policy itself, looking at its soundness and how well it is being implemented. The Committee notes that much of what is said about user charges can be expanded to include regulations in general. Consequently, Part I concludes with a recommendation that the government review also its regulatory regime, in the spirit of the Committee's cost-recovery review. Part II examines the policy's implementation through three case studies: on Health Canada, specifically user charges faced by drug manufacturers in the Therapeutic Products Programme, on Agriculture and Agri-Food Canada, and on the Marine Service Fees charged by the Canadian Coast Guard.

The Committee also notes that federal user charges comprise only part of the government charges faced by Canadian businesses. While this Report is centred on the federal government, provincial and municipal governments

[3] Auditor General of Canada. 1997 *Report of the Auditor General*, December 1997, "Matters of Special Importance," http://www.oag-bvg.gc.ca/domino/reports.nsf/html/ch97age.html.

should also examine their fee structures to ensure that Canadian businesses do not face an overly burdensome user charge and regulatory burden. The challenges faced by the federal government in implementing its user-fee program apply equally to other levels of government.

One easily overlooked benefit of user charges is that, by bringing the cost of government services out into the open, they have raised the level of awareness as to how government works. It has also spurred the discussion as to how to run a more efficient government. It is important to note that this ongoing discussion, of which this Report is part, itself represents significant progress.

By bringing the cost of government services into the open, user charges have raised awareness as to how government works.

PART I:
THE USER CHARGE AND COST RECOVERY POLICY

SCOPE OF USER CHARGES

User charges for government services are nothing new. In 1965-66, one measure of user charges[4] found that they accounted for 1.6% of federal government revenue. Since then, the overall importance of user charges has risen somewhat: a wider definition of user charges places them at 2.4% of government revenue, albeit much larger revenue, in 1998-99.

Overall, user charges contribute very little to the federal budget.[5] However, on a program-by-program basis, the institution of cost recovery has seen user charges increase dramatically. In 1998-99 there were 391 user-charge programs in 47 departments and agencies, bringing in $3.7 billion in fees. This was up slightly from $3.5 billion in 1994-95. These user charges cover everything from admission to federally run parks and rent for crown lands, to mandatory licensing fees and fees for passports.

In 1998/99 there were 391 user-charge programs in 47 departments and agencies, bringing in $3.7 billion in fees.

A. Economic Rationale for User Charges

While user charges are often seen, sometimes with good reason, as a tax by any other name, there exist several good reasons why user charges are potentially valuable tools for both the government departments providing the service and service users themselves. Professor Bird and University of Toronto Professor Thomas Tsiopoulos state that "whenever possible and desirable, public services should be charged for rather than given away."[6]

As Professor Bird told the Committee: "(T)he appropriate starting point for any discussion of user charge policy in government has to be that any service provided by a public agency, (for) which there's an easily identifiable, direct beneficiary — it could be a group rather than an individual — should be paid for by that beneficiary, unless and only unless sound and convincing arguments in favour of a particular degree of explicit public subsidy can be produced." According to Professor Bird, "the onus for proof of any other position should always be on those who support subsidization. Or to put it another way, the use of other people's money to provide services from which they personally benefit."

Any service provided by a public agency, (for) which there's an easily identifiable, direct beneficiary should be paid for by that beneficiary. The onus for proof of any other position should always be on those who support subsidization.

Richard Bird,
Professor of Economics,
University of Toronto

[4] In this case, privileges, licences, and permits, and sales of goods and services.

[5] As a source of revenue, user charges are much more important to provincial and municipal governments.

[6] Treasury Board, Secretariat. *User Charging in Canada: A Background Document.* Undated. Paper prepared by Richard M. Bird and Thomas Tsiopoulos in consultation with the Treasury Board Secretariat. www.tbs-sct.gc.ca/Pubs_pol/opepubs/TB_H/UCFG_e.html.

Properly designed, user charges can serve as price signals that can contribute both to equity and efficiency.

Properly designed, user charges can serve as price signals that can contribute both to equity and efficiency. Efficient programs help assure that scarce resources are put to their best possible use. On the government side, attaching a price to a government-provided service allows officials to see how much of it is demanded by users. As the April 2000 Auditor General's report remarks, "We found that where a service involves user fees or cost recovery (charging a user for the costs of using a service), better cost information is generally available." The report notes in even stronger terms, "We are concerned that without good cost information, service managers do not have the information they need to provide the highest quality of service at the lowest possible cost."[1]

From the user side, when consumers are not charged for a government service, they will tend to use more of the service than is socially optimal. In reality, it costs something to produce a "free" service; these additional resources could have been used to provide something else of value: other services, debt or deficit reduction, lower taxes. This overconsumption can also act as a perverse signal for government to provide even more of an already overused service.

In theory, faced with an explicit price for a service, ideally equal to its marginal cost (the cost of providing an additional unit of the service) consumers will demand a socially optimal amount of that service. This signalling of the appropriate demand level encourages both the minimizing of costs and greater efficiency of delivery.

Users of government services, in principle, should gain from well designed charges in the sense that they get what they pay for and the nation in general should also gain by making better use of the resources that citizens have transferred to the government.

Richard Bird

As Professor Bird remarked, "Revenue is not the point. The point is rather to make governments accountable for how they use resources by ensuring that direct users value what they get at least at the economic cost of producing it. So, users of government services, in principle, should gain from well-designed charges in the sense that they get what they pay for and the nation in general should also gain by making better use of the resources that citizens have transferred to the government."

This will not happen, added Professor Bird, "unless the revenues from charges are formally linked through the budgetary process to the expenditures with respect to which charges are levied." There is more to it than that, however. Other revenues cannot be negatively linked to these user-charge revenues.

Regarding equity, when relatively more affluent Canadians use a service provided free by the government, society, including the less affluent, is subsidizing their activities. Charging for the use of such services (such as boat-docking fees) can in such cases be seen as a progressive move.

[1] *2000 Report of the Auditor General of Canada*, Chapter 1, "Service Quality," 1.96, 1.97.

B. When Are User Charges Appropriate?

This question of public and private goods and services is central to the discussion of user charges. Simply put, "private" services should be subject to user charges, while "public" services should not. Further, most economists would argue that if a good or service can be priced like a good in the private market, then it should probably be delivered by the private sector.

In determining whether a good or service is a private or public good, economists look for a number of characteristics. If its consumption by an additional consumer does not affect its consumption by others (rivalness), then it is considered to be a public good or service. Similarly, if it is difficult to prevent non-payers from enjoying a service (excludability), then it is a public good or service. Otherwise, it is a private good.

The classic example of a public good in this sense is national defence. Even an individual who has managed to avoid paying taxes receives the benefits of this service. In contrast, the benefits from a private service like skydiving lessons accrue only to the individual taking the lessons.

The private sector is typically unable to provide efficiently goods and services where indirect positive or negative impacts occur (externalities), or where specific social or political objectives are sought. In these cases, government intervention is appropriate. Mr. Richard J. Neville (Deputy Comptroller General, Treasury Board Secretariat) told the Committee that: "There are several government programs that spend money to protect the public from risks associated with industrial activity. According to our cost-recovery policy, some part of the costs of these programs should be borne by the industry that originated these risks. Some of these costs belong, according to this argument, to the cost of production of that industry. They are industry costs, and should be internalized."

Using the tax/transfer system to take into account externalities has long been advocated by economists as a way of achieving economic efficiency. That in itself is quite different from cost recovery proper.

A basic criterion for a user charge is the ability to identify individuals' consumption of a good or service: charging for a fishing licence is much easier than charging someone for their share of national defence. It makes sense to charge for a fishing permit: the holder of the permit is easily identifiable, receives a benefit not available to others (the fish he catches) from a public resource (the fishery).

However, simply being able to identify the direct recipient of a government service does not mean that a user charge should be levied. Instead, we must look at who benefits from the provision of the service. This is a task made more

difficult by the fact that most government services on which we could place user charges are characterized by a mixture of private and public benefits. Testing of new drugs, for instance, clearly has a public component, in that it assures that no harmful drugs are sold in Canada, but it also provides a benefit to the drug company, in that it signals that their good is of a high quality. In such a case, it makes sense that the user pay for the benefit received, with the rest being covered from general revenues. The value of the private benefit produced by the government service is the benefit in excess of that which could be achieved through other means. For example, if a drug has been approved in the United States, England, Japan, etc., what is the incremental value, as a signal of quality, of the drug's approval in Canada? On the other hand, if Canadian approval is early, the private benefit is large.

Even after a service has been placed along the public/private continuum, deciding what to charge is very difficult. Economic theory holds that the best policy is to charge a price equal to the marginal cost, as happens in a perfectly competitive market. However, marginal costs — the cost of producing an additional unit of a good or service — are difficult to calculate. Ideally, marginal costs include not only the direct financial cost of production, but also the opportunity cost of production. For instance, in considering what to charge for admission to a park, one must consider not only upkeep costs but also the potential revenues from all alternative uses of the land.

Efficient prices must also account for existing complements of and substitutes for the service. Finally, if the costs of implementing the user charge are greater than its benefits, then no user charge should be implemented.

A good user charge should approximate the price that the service in question would attract in the private sector; this is, of course, not always possible. As well, for political and bureaucratic reasons, public-sector charges are very sticky; once a price is set, it is difficult to change. For this reason, and because there is no competitive pressure on many government user-charge programs, it is important that the process of setting charges be as open as possible. Allowing Canadians in general and interested parties in particular to participate in the process of setting fees helps assure that user charges are more than just revenue sources. Making the fee-setting process as transparent as possible also allows affected groups to see the benefits (e.g. efficient service delivery) of user charges.

C. The Special Case of the Monopoly Provider

Any monopoly, public or private, is likely to exploit its economic power to extract the maximum return from its unwilling clients if it can get away with it. So it becomes particularly important to ensure

> that the prices set are reasonable and particularly difficult in many instances to persuade those who must pay them that they are. (Professor Richard M. Bird)

It is essential to note that the efficiency case for user charges rests on the assumption that competition exists. Prices can only act as an efficiency signal if they cause the quantity demanded to change: a price increase should cause a drop in the quantity demanded of a service. However, many government services are mandatory, not voluntary. In the case of fees for drug approvals, a company can only decide not to have its drugs tested in Canada by refusing to offer those drugs in Canada. Government in these cases is a monopoly supplier.

A lot of what government does, people don't have the choice of taking the service or not: it's a mandatory service. Moreover, in many cases it's a mandatory service provided by a government monopoly, so it's all too easy for user charges to become taxes.

Richard Bird

Ideally, where consumption of government goods and services is voluntary, the government's attempt to maximize returns by setting price equal to marginal cost will also maximize overall welfare because it will lead to an efficient use of resources. However, when it acts as a monopolist, maximizing its returns results in socially suboptimal prices. According to Professor Bird, "a lot of what government does, people don't have the choice of taking the service or not: it's a mandatory service. Moreover, in many cases it's a mandatory service provided by a government monopoly, so it's all too easy for user charges to become taxes."

This does not mean that user charges should never be implemented for mandatory activities. Again, where the user of a service obtains from that service a benefit not available to all other consumers, that user ideally should pay for the benefit received.

It is important to consider the question of who benefits from the service provided. Canadians benefit, for example, by keeping harmful products off the market. It is also possible that firms should pay a share for their own self-regulation. Mr. Dann Michols (Director General, Therapeutic Products Programme, Health Protection Branch, Health Canada) made the case that, "In our opinion, there is no philosophical contradiction presented by the fact that the industry making a profit from the sale of its products should pay for some of the costs of the apparatus that society has to put into place to ensure that these products are safe, effective, and of high quality."

Mr. Michols suggested that industry benefits from an efficient, highly qualified regulator, because it signals that their products are of a high quality. Again, the question of degree is a difficult one. Bird and Tsiopoulos provide the other point of view: "The clients for most regulatory services … can only by a considerable stretch of the imagination be considered to be direct beneficiaries of the services they consume, which are presumably designed to achieve some broader public purpose."[8] In other words, the beneficiaries of the drug approval process are not drug companies but consumers of drugs.

The clients for most regulatory services … can only by a considerable stretch of the imagination be considered to be direct beneficiaries of the services they consume, which are presumably designed to achieve some broader public purpose.

Richard Bird and Thomas Tsiopoulos

[8] Richard M. Bird and Thomas Tsiopoulos, "User Charges for Public Services: Potentials and Problems," *Canadian Tax Journal*, 45, No. 1, 1997, p. 45.

Setting efficient mandatory user charges is made more difficult by the reality that there often exists no corresponding private-sector good to use as a basis for setting prices. Since consumption is unresponsive to changes in price, it is difficult to find an optimal competitive price. Ideally, the starting point for charging mandatory fees should be the cost of the service; in other words, cost recovery. (Again, determining the correct breakdown of public/private benefits is notoriously difficult.) This allows for prices to approximate what would be charged in a competitive market, minimizing the impact of service charges on the economy.

Great care must be taken in imposing user charges for mandatory activities because of this lack of price signals. Because regulated firms have to pay the charges to stay in business, it is vital that regulators be sensitive to the situation of the regulated group. What's more, as Professor Bird told the Committee, the political acceptability of user charges "to a considerable extent probably depends upon the extent to which the prices charged actually go to finance the services for which they are charged."

WHY USER CHARGES MATTER

[Cost recovery] has major implications for the Canadian economy in terms of productivity, employment and access to innovation, access to products.

Jayson Myers, Senior Vice-President and Chief Economist, Alliance of Manufacturers and Exporters Canada, Co-Chair, Business Coalition on Cost Recovery

As the Committee heard, the Cost Recovery Policy and its implementation "has major implications for the Canadian economy in terms of productivity, employment and access to innovation, access to products." (Mr. Jayson Myers, Senior Vice-President and Chief Economist, Alliance of Manufacturers & Exporters of Canada, Co-Chair, Business Coalition on Cost Recovery) Far from being simply "the cost of doing business," user charges, like taxes, impose potentially important transaction costs on economic activity. By increasing their costs, user charges affect firms' profitability and their ability to compete.

Canada is a small market. As such, prohibitively large charges for the approval of new drugs or environmentally friendly pesticides, for instance, can reduce Canadians' access to cutting-edge technology as foreign firms wishing to sell these technologies find that the high fees make it unprofitable for them to do so. Domestically, high charges can stifle firms' incentives to innovate. This in turn reduces their ability to generate employment.

The effects of such charges are often disproportionately borne by small- and medium-sized enterprises (SMEs), the growth engines of the Canadian economy. A $100,000 licensing fee presents a much greater burden on an SME than it does for a large multinational, to say nothing of the paperwork required to obtain a licence. A good user charge should consider the size of a business affected by the charge.

The Business Coalition on Cost Recovery (BCCR) has conducted one of the few studies on the effects of user charges on the economy. Its rough results suggest that in 1996-97, the $1.67 billion in fees paid by business reduced economic output by $2.56 billion, GDP by $1.37 billion, and employment by almost 23,000 jobs. Lost taxes on this foregone economic activity and job creation (through "increased" EI premiums) means that the $1.67 billion received in fees netted only $270 million in additional funds.[9]

That user charges, like taxes, distort economic activity is not an argument for their removal; an Infometrica study commissioned by Treasury Board found that taxes equivalent to the user charges currently in place have a similar effect on the economy. However, broad-based taxes are likely to have lower transaction, compliance and administrative costs than user charges.

In order to assess fully the effects of user charges, one has to look also at their benefits. A good user-charge program is one for which the transaction, compliance and administration costs are outweighed by its benefits. This is made explicit in the Cost Recovery and Charging Policy: "A cost-recovery regime is only appropriate where the benefits to the government outweigh the startup and ongoing costs of administering the charges."

A cost-recovery regime is only appropriate where the benefits to the government outweigh the startup and ongoing costs of administering the charges.

Cost Recovery and Charging Policy

Just as Canada could benefit from an improvement in our user-charge programs, we could benefit from a well-designed regulatory regime in general. As the Committee heard, "While the market size of other countries will forever overshadow that in Canada, the capacity to lead the world by providing fast and globally respected technology registrations could distinguish Canada as a global discovery centre. To do such could foster significant R&D investment while also providing Canadian growers with a competitive advantage of being the first to utilize state-of-the-art technologies." (Mr. Charles D. Milne, Vice-President, Government Affairs, Crop Protection Institute)

While the market size of other countries will forever overshadow that in Canada, the capacity to lead the world by providing fast and globally respected technology registrations could distinguish Canada as a global discovery centre.

Charles D. Milne, Vice-President, Government Affairs, Crop Protection Institute

LACK OF INFORMATION

The Committee found it difficult to generate a complete picture of the government's cost-recovery program. Information on the government's 391 user-charge programs is spread out over 47 departments and agencies, and the comprehensive list kept by Treasury Board does not provide enough detail as to the nature of the charges, lumping together voluntary and mandatory, business and consumer charges. This information is vital to the success of any meaningful reform of Canada's cost-recovery program.

At the department level, the Policy requires that programs submit user charges to business impact analyses: fees that impose too great a cost on business are either to be revised or eliminated. Despite this requirement, no

Because government regulation is there to protect health and environment, you don't just compare the costs, you've got to look at the results.

Jennifer Hillard, Vice-President, Issues and Policy, Consumers' Association of Canada

[9] Blair Consulting Group, for the Business Coalition on Cost Recovery, *User Fees: Where Does the Buck Stop?*, January 1999, p. iii, 55.

comprehensive analysis of the total, cumulative effect of all user charges has ever been undertaken. This makes it difficult, if not impossible, to evaluate whether or not the benefits of the User Charge Policy (most studies that have been conducted centre only on the costs of regulation) outweigh its costs. Regarding the measurement of benefits, the Consumers' Association of Canada emphasized the need for a study of the benefits of cost recovery and regulation: "Because government regulation is there to protect health and environment you don't just compare the costs, you've got to look at the results." (Ms. Jennifer Hillard, Vice-President, Issues and Policy, Consumers' Association of Canada)

The general consensus amongst analysts is that, at all levels of government, "most existing user charges have more to do with the search for revenue than with any economic principle."

Richard Bird and Thomas Tsiopoulos

The analyses that have been done are not encouraging. According to the 1997 survey article by Bird and Tsiopoulos, all studies on user charges at all levels of government have "reached the same conclusion: what is now being done in the way of charging for public services is for the most part done badly." The general consensus among analysts is that "most existing user charges have more to do with the search for revenue than with any economic principle."[10]

Treasury Board officials have indicated that a mandated review of the Cost Recovery Policy is about to get underway, and should be completed by next winter. According to Treasury Board officials, the review will involve consultations with government, industry and other interested groups. However, this review must do more than simply examine the Policy's nuts and bolts.

Recommendation 1:

The Committee is concerned that the upcoming Treasury Board review of cost recovery, while dealing with important questions of implementation, will not be sufficiently broad in scope. Therefore, the Committee recommends that a Committee of Parliament conduct a government-wide study of the Cost Recovery and User Charge Policy to evaluate both its benefits and costs. This should serve as the basis of any policy reform.

One of the difficulties in conducting such a study, and with cost-benefit analysis in general, is measuring qualitative effects. However, any attempt at such a measure is surely preferable to the current situation, in which no information exists on benefits.

The transparency of information on user charges is a related matter. While Treasury Board collects information on user charges, it is not easily accessible to the public, either by department or by program.

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[10] "User Charges for Public Services: Potentials and Problems," p. 71.

At present, obtaining complete information on user charges — their size, structure, etc. — requires contacting 47 separate departments and agencies. This does not make sense, especially as a central agency, Treasury Board, is charged with monitoring the Policy. Further, like taxes, it makes sense that user charges be reported separately.

Recommendation 2:

That information on user charges be made easily available to all interested parties. It should include the formula used to determine the user charge, an indication as to whether it is a mandatory charge, whether it is a business charge, the amount of revenue it generates, and the performance promised by each user-charge program. The estimated public/private benefit split should be included, as well as its justification.

Recommendation 3:

Fee revenues should be published annually, with the publication of the budget.

QUALITIES OF A GOOD USER-CHARGE POLICY

Beyond the economics of a good user charge, a sound cost-recovery policy requires effective oversight, funding and dispute resolution. On these issues, this Committee found a great deal of harmony among witnesses — from industry, government agencies, the Office of the Auditor General and academia. The Committee found these ideas useful in evaluating the current policy.

The Office of the Auditor General summarized these issues in its December 1997 report: "Have departments minimized their costs before asking users to pay? Have the financial, competitive and socio-economic impacts of user charges, in both the short and long terms, been considered? Are there proper redress mechanisms for stakeholders? And perhaps most important for parliamentarians: does Parliament have the information it needs to keep an eye on this issue?"[11]

Have departments minimized their costs before asking users to pay? Have the financial, competitive and socio-economic impacts of user charges, in both the short and long terms, been considered? Are there proper redress mechanisms for stakeholders? And perhaps most important for parliamentarians: does Parliament have the information it needs to keep an eye on this issue?

1997 Report of the Auditor General

- **Consistency, accountability and transparency.** As with taxes, individuals and firms facing user charges should be able to expect a degree of consistency in user-charge quality from department to department. Because they are linked to a service, user charges should also be linked clearly to

[11] Auditor General of Canada. *1997 Report of the Auditor General*, December 1997, "Matters of Special Importance," http://www.oag-bvg.gc.ca/domino/reports.nsf/html/ch97age.html

the cost of the service provided. Clear dispute-resolution mechanisms are required, as is a strong central overseer with the powers to enforce consistency among departments.

Too often the introduction of cost recovery is accompanied by a reduction in government funding.

Jean Szkotnicki, President, Canadian Animal Health Institute

- **Revenue should be a secondary target.** As more than one witness observed, user charges have been seen by departments as revenue generators making up for budget cutbacks. "Too often the introduction of cost recovery is accompanied by a reduction in government funding." (Ms. Jean Szkotnicki, President, Canadian Animal Health Institute) As a result, departments ignore the efficiency gains available from the use of user charges. Tellingly, according to Ms. Szkotnicki, "in the U.S. the Prescription Drug User Fee Act specifically states that appropriations to the FDA cannot be cut in those areas where user fees are administered. In other words, user-fee revenue is specifically meant to complement, not replace, government appropriations."

- **Consultation and Impact Assessments:** Government departments should consult with those who will be paying their user fees, and conduct impact assessments, in order to assure that the benefits of user charges are not outweighed by their costs. Special attention should be given to the plight of small businesses, for which user charges and regulatory requirements often present a disproportional burden.

THE COST-RECOVERY POLICY: ISSUES AND CONCERNS

> There's a disconnect between the theory and what's actually being implemented. (Ms. Szkotnicki)

A. Chain of Command

1. Oversight

The present Cost Recovery and Charging Policy was adopted in April 1997. It makes explicit the need for cooperation and "meaningful and effective consultations" among departments and agencies and their "clients," as well as "other affected parties to ensure that competing policy objectives are not compromised." Treasury Board is the keeper of the Policy, and is charged with monitoring adherence to the Policy, "through client feedback, internal and external audits, program evaluations, special studies, and the review of annual Departmental Business Plans."

However, it has been left to the departments and agencies to devise and implement compliant cost-recovery programs, and set up an appeal process.

Specifically, "departments must conduct periodic reviews to ensure user-charge policy requirements are being met. Such reviews should also address whether fees should be increased or decreased where cost structures have changed, where the mix of public and private benefits has changed, or where service levels have been altered." The Policy also stipulates that "(d)epartments and agencies should be open to client requests for reviews of any unforeseen impacts which emerge." (Cost Recovery and Charging Policy)

The President of the Treasury Board "will serve as a point of contact for clients who feel departments or agencies have not given them a fair hearing in the fee-setting process." (Cost Recovery and Charging Policy)

This decentralized approach to user charges presents several problems. First, under this policy, and confirmed by testimony, departments have the main responsibility for assuring that user-charge programs are being implemented fairly, consistent with Treasury Board rules. Treasury Board seems to be taking a passive role as to the workings of the Policy. For instance, it is taken on faith that user charges across the government do not account for more than 100% of the cost of their programs. Mr. Neville told the Committee that this belief rests on the fact that "that's one of the principles. ... We haven't had any indications at this point that there is no inordinate imbalance between the two."

According to Mr. Milne, in a statement echoed by other witnesses, cost-recovery guidelines are being interpreted and enforced inconsistently. "Departments and agencies were left to make their own interpretations of how cost recovery would be implemented, resulting in a variety of differing operating styles in cost-recovery programs across government."

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Charles D. Milne

While decentralization allows departments to tailor cost-recovery programs to suit their specific needs, it also means that departments could be implementing the Policy inconsistently. Indeed, the Committee heard testimony from business groups that the treatment and analysis of business impact studies, even the existence of appeals processes varies from program to program.

What is required, as Mr. Neil Maxwell (Principal, Audit Operations, Office of the Auditor General of Canada) told the Committee, is "less of a piecemeal approach to implementing user-fees program by program and more something driven by an overall departmental strategy." It is the Committee's contention that a well-thought-out cost-recovery policy would go a long way to addressing these concerns.

2. Public/Private Benefits

The Cost Recovery and Charging Policy is mostly silent on the issue of determining public and private benefits. Mr. Michols told the Committee that in the Health Protection Branch a lack of guidance from Treasury Board regarding the calculation of public/private benefits meant that his department had to "develop our own theory to a large extent."

The objective review of a drug or a pesticide assures and protects society, regardless of whether or not the applicant receives the registration. There appears to be a lack of clarity about whether the client is the payer or society.

Charles D. Milne

Mr. Milne also remarked on the confusion over what is a public or private benefit under the Policy, raising the ever-present question of whether private industry should even be paying for mandatory services. "(I)f people are paying for participation on a trade mission or for a passport, that's a discretionary decision, and a private benefit accrues to those who pay. The objective review of a drug or a pesticide assures and protects society, regardless of whether or not the applicant receives the registration. There appears to be a lack of clarity about whether the client is the payer or society." This is precisely the point made by Professor Bird.

On that particular issue of what is a public versus private good, there's a need for a certain amount of clarification of that. Direction from members of Parliament would be very helpful.

The Auditor General

The Auditor General also pressed the government on this issue. "On that particular issue of what is a public versus private good, there's a need for a certain amount of clarification of that. Direction from Members of Parliament would be very helpful."

Recommendation 4:

More central guidance is needed in the implementation of the Cost Recovery and Charging Policy. Specifically, stricter guidelines for determining public/private benefits should be put in place. This will help assure that programs with user charges are not starved of general tax revenues, which represent the public investment in this activity.

Recommendation 5:

Uniform standards should be established by Treasury Board to be applied by all departments and agencies. Deviations from those standards must be justified by the departments and agencies.

3. Dispute Resolution

The President of the Treasury Board is the final stage in the appeal process. However, the responsibility for the appeal process is left largely to the departments. This places the minister and the department in a conflict of

interest: the department is in effect being asked to rule on something that could affect the amount of revenue received by the ministry. Further, as Mr. Garth Whyte (Senior Vice-President, National Affairs, Canadian Federation of Independent Business) remarked to the Committee: "In every other area where there is dispute resolution — NAFTA, internal trade barriers, whatever — you need another sort of neutral body. Where does that business owner go if they have a problem? If we have a coalition of 20 different business associations saying they have a problem, and we're going to Treasury Board saying, 'Here are some things we'd like to talk about,' what does it take to deal with it?"

In the absence of central leadership, many disparate mechanisms have sprung up. Ms. Szkotnicki, as Co-Chair of the BCCR, related to the Committee some inconsistencies with the appeal process. "In working with the Canadian Food Inspection Agency relative to the approval program for veterinary biologics, we have found that by taking it up the ladder to senior bureaucrats and to Minister Vanclief, that indeed there is concern and they're going to look at developing measures to bring us back to performance standards."

"But we followed the same route on the veterinary drug program and frankly, it's like the black hole. We keep going back. There's no sign of any relief relative to the veterinary drug program. There's no game plan of how to improve the situation in that agency — and it is an agency with great problems."

The quality of the various appeal processes is unclear. Mr. Neville told the Committee: "There are in excess of 400 programs that are on cost recovery or components thereof. Therefore, we don't monitor each and every one to see if there is a dispute resolution process. We hear from time to time that there isn't and that's because of the fall-back mechanism of having the President of the Treasury Board intercede where there is an impasse."

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Richard J. Neville,
Deputy Comptroller
General, Treasury Board
Secretariat

The problem was summarized by Mr. Myers, who remarked that, "The need to take it up the ladder indicates to me that there is no dispute-settlement process in programs and that should be there right from the very beginning."

"Secondly, I think in the discussions today I see some of the difficulties that are coming out here when you say to go to the departments. What we found is that the implementation of these programs is very much at the discretion of certain departments. Some agencies and departments consult well, they've implemented these things well. Others do not. And that's part of the problem here. There's no overall oversight monitoring or overall requirement of performance, and there's no one to enforce that."

Some agencies and departments consult well, they've implemented these things well. Others do not. And that's part of the problem here. There's no overall oversight monitoring or overall requirement of performance, and there's no one to enforce that.

Jayson Myers

It is essential that user charges be seen as fair to those paying them, especially in the case of mandatory user charges, where users have no choice but to pay. Again, we return to problems with the Cost Recovery Policy. While

I would point out to you that the policy of 1997 in no way defines what a dispute mechanism is. As such, it is very much in the eye of the beholder.

Jean Chartier,
CFIA Vice-President, Policy
and Regulatory Affairs

the Auditor General found that Canadian Food Inspection Agency (CFIA) did not possess a formal dispute-resolution process, CFIA Vice-President, Policy and Regulatory Affairs, Mr. Jean Chartier, stated that his agency genuinely believed they in fact did have one in place. As he told the Committee, "I would point out to you that the policy of 1997 in no way defines what a dispute mechanism is. As such, it is very much in the eye of the beholder." It is the Committee's belief that this should change.

Recommendation 6:

An open, clear and independent appeal process for those affected by user charges is essential to the well-functioning of any cost-recovery policy. Thus, the Committee calls on the government to create an explicit appeal process and to set up a third-party Ombudsman to deal with user-charge complaints.

4. Parliamentary Accountability

One of the consequences of the lack of oversight of the Cost Recovery Policy is the lack of effective accountability. This can be seen through the descriptions of inconsistent appeal processes. It also serves to highlight departments' lack of Parliamentary accountability in setting and collecting user charges, which annually amount to several billion dollars. Since, like taxes, user charges can have a substantial effect on productivity, prosperity and innovation, it is important that Parliament have an effective way of monitoring the introduction of new charges and increases in rates of existing charges. Parliament should also monitor the effects of existing charges. This would also help involve Canadians not directly affected by user charges but who, as Canadians, have an interest in these programs.

Recommendation 7:

Since user charges are similar to taxes, greater scrutiny is required. This cannot be left to individual government agencies. All new user charges, and changes to user charges, should therefore be subject to scrutiny by a parliamentary committee and adopted only if approved by the committee. This would aid accountability and assure that only appropriate fees are implemented. Parliament should also re-examine existing charges to ensure that they are well designed and well implemented.

B. Business Impact Assessments

According to the Policy, departments and agencies are also required to:

- Conduct impact assessments to identify all significant effects, positive and negative, and factor those results into sound fee-setting decisions;
- Work with clients to assess the cumulative impact of multiple fees from all federal sources, and assess proposed fees in that context;
- Identify and explain clearly to clients why services are being delivered in the manner they are, how charges are determined, and how costs are being controlled;
- Provide feedback to clients on concerns expressed and suggestions made, in a timeframe that is relevant to the process; and
- Establish a dispute resolution process to address client complaints which reach an impasse stage (e.g. an advisory panel to the Minister).

It is unclear how well departments have lived up to the promise to consult with businesses about user charges. Regarding business-impact analyses, the Committee heard that they are not treated seriously by departments. According to Ms. Szkotnicki:

> Frequently ... the impact of cost-recovery fees on the economy and industry are not addressed, or are simply ignored. Too often the focus of the fee-charging agency is on the need to generate revenues, rather than the need to provide value. Industry Canada, for example, compiles a comprehensive inventory of Canadian bankruptcy data. Industry Canada now charges about $250,000 per year for this data. In one affected market, a single small Canadian company competes for business with three U.S. multinationals. The need to pay this fee places the Canadian economy at a serious competitive disadvantage with its customers.

The Canadian Federation of Independent Business (CFIB) pointed out to the Committee that one of the elements to be considered in determining the impact of cost recovery is the issue of productivity. In fact, cost recovery is perceived as a major impediment to improving small business productivity. More than one out of four CFIB members identified this issue as a priority to improve their firm's productivity.

In the Therapeutic Products Programme (TPP) of Health Canada, the BCCR report claimed that the TPP had largely failed to act on both industry reports and a third-party report by Price Waterhouse, and that a joint

business-government committee has proved to be "a useful forum for discussion," but nothing more.[12]

Regarding the Canadian Coast Guard's Marine Service Fees, two disputed studies have already been conducted. A third study by Treasury Board was announced in mid-1998. According to Mr. Wayne Smith (Vice-President/General Manager, Seaway Marine Transport, Canadian Shipowners Association), "It's been over a year and a half. It's still trying to get off the ground and is progressing very slowly."

We're not required to look at those (economic impact) assessments. We take it that the department concerned is carrying it out in a viable manner and sharing that information with the parties concerned.

Richard J. Neville

It is difficult to know whether these anecdotal stories add up to a systemic government problem because of the high degree of decentralization of responsibility for the Cost Recovery Policy. As Mr. Neville remarked, impact assessments are the responsibility of individual departments. That this part of the Policy is being conducted well seems to be taken on faith: "We're not required to look at those (economic impact) assessments. We take it that the department concerned is carrying it out in a viable manner and sharing that information with the parties concerned."

Treasury Board, said Mr. Neville, has "discussions with departments on an ongoing basis. We have feedback from departments and from a number of users. I would say that we're aware of a good majority of what's being done but we can't be aware of what's being done in 103 departments and agencies all the time."

Recommendation 8:

The Committee recommends that Treasury Board state explicitly what is required in business impact assessments and verify that they are being conducted by the departments. Wherever possible, international comparisons should be made.

This recommendation goes to the heart of the problems with the Cost Recovery and Charging Policy: it is not being implemented consistently.

[12] User Fees: *Where Does the Buck Stop?*, p. 32.

C. The Policy and Pricing

The Policy notes that "charging ... cannot be used simply as a means of generating revenue to meet the funding requirements of a department or agency. There must be a relationship between the fee charged and the cost of the good or service, or the value of the privilege provided to clients."

Also in keeping with economic theory, the Policy's stated goals are:

- To promote the efficient allocation of resources;
- To promote an equitable approach to financing government programs, mandatory or otherwise, by fairly charging clients or those who receive a benefit from services beyond that enjoyed by the general public; and
- To earn a fair return for the Canadian public for access to, or exploitation of, publicly owned or controlled resources.

Consequently, it calls on departments to use prices based on market values where possible. Prices are also supposed to take into account policy considerations, such as externalities, and public/private benefits. In the case of regulatory services, prices should be cost-based; the Policy notes that, "Even in situations where services are mandatory, there may be scope for tailoring the service to better suit the operations of the clients it serves." Further down, it states: "Fees should be set on the basis of clear, and preferably agreed upon, service standards and performance measures unless it can be demonstrated that it is not practical or reasonable."

D. Economic Evaluation of User Charges

The Policy generally conforms to good economic practice: charges are supposed to be related to cost and to approximate marginal-cost pricing where possible, and the economic impact of the charges are supposed to be taken into account. User charges are supposed to be used not as revenue generators, but as a means to encourage efficiencies and to "get government right." At the policy level, there is a clear intent that user charges not be taxes of another kind. Whether the Policy is working properly in practice is another question. Regarding mandatory fees, the BCCR report states: "If this policy was being followed by those departments who require mandatory fees for regulatory services, over half the battle would be won. But it is not being followed, and has not been enforced by the Treasury Board."[13]

At the policy level, there is a clear intent that user charges not be taxes of another kind. Whether the Policy is working properly in practice is another question.

The situation does not seem promising. As Bird and Tsiopoulos remark, "much of what is currently going on across Canada under the banner of 'user charges' makes little sense. Some activities that are being priced probably

[13] Ibid., p. 30.

should not be. Many of the charges imposed may not provide the right economic incentives. Some of the public criticisms of 'revenue grabs' may be justified. Finally, nowhere, it seems, is government doing a very good job of explaining either to citizens in general or to the users (and managers) of particular services why charges, and why these particular charges, should be imposed."

And again: "As a rule, what is currently priced by government, and how it is priced, reflects historic accident and administrative convenience as much as — or more than — it reflects rational policy."[14] This is true of all levels of government, not just the federal government.

The policy as it is written neglects to treat in a substantive manner the important differences, already discussed, between voluntary and mandatory user charges. Mandatory charges usually apply to services like licensing and inspections. In these areas, though a direct user can be easily identified, it is unclear what private benefit that direct user is paying for. It is valid to ask whether they should even be charged for the service, which has a very large public benefit component (e.g. food inspections to assure quality).

Industry groups have sometimes made the serious allegation that user charges for mandatory services are little more than taxes by another name. The Supreme Court seems to have commented on this in ruling in October 1998 that mandatory user fees that bear no relation to the costs involved in providing a service are a de facto tax. Since taxes cannot be set by regulation, only by legislatures, the charge in question (probate fees for wills in Ontario) was ruled illegal.

For medical device manufacturers, no service is being provided, no inspectors inspect the facility and there are no identifiable service standards that must be met to obtain the establishment licence. This is a tax, not a fee. There is no service being provided in this case.

Jean Szkotnicki

According to Ms. Szkotnicki, "fees have become taxes. Unfortunately there are far too many examples of fees being charged for services that are not being provided. Perhaps the best example of this comes from the drug and medical devices manufacturing industry. Health Canada requires drug and medical device manufacturers to pay an annual establishment licence fee. For medical device manufacturers, no service is being provided, no inspectors inspect the facility and there are no identifiable service standards that must be met to obtain the establishment licence. The only transaction that takes place is that a fee is paid and a certificate is issued saying that the applicant can run a manufacturing facility. This is a tax, not a fee. There is no service being provided in this case."

As this is clearly not the intent of the Policy, the fault lies with its implementation and not its design.

[14] "User Charges for Public Services: Potentials and Problems," p. 35. It should be noted that this article is discussing user charges at all levels of Canadian government, not just federal user charges.

E. User Charges as Revenue Generators

The government's 1994 Program Review occurred at a time of acute government cutbacks; user charges, in many corners, were seen by departments as a way of maintaining cut budgets. In some cases cost-recovery programs have been structured to bring in a targeted amount of money. Between 1994-95, when Program Review was implemented, and 1996-97, user charges rose 17% (from $3.5 billion to $4.1 billion), as program spending fell 7%. Mandatory regulatory fees paid by Canadian businesses rose by 47% between 1994 and 1996.[15]

This Committee heard that government restructuring in the wake of Program Review of 1994 made the implementation of sound cost-recovery programs more challenging. In the Agriculture and Agri-Food Department, Mr. Chartier told the Committee:

> Certainly, program reviews in themselves created also a lot of challenges for the different departments to adjust to the new reality of globalization and of the new economy. On top of that, if I can speak for the Canadian Food Inspection Agency, its sheer creation back in 1997 — created, again, from four different departments — created some other challenges on top of that. If we add the notion that we had to come to grips with the moratorium that was set in place (fees are frozen until 2002), all of those different events have together made it a little bit more complicated to fully implement the intent and the thrust of the policy that was revised back in 1997.

Though the raison d'être of user charges is supposed to be improved efficiency of government-provided services, and not revenue generation, the Committee heard evidence that revenue generation was a major factor in the design of these fees. As the TPP's Mr. Michols described it, resources that were available were a factor in setting fees.

Discussing the Canadian Food Inspection Agency (CFIA), the Auditor General said, "(T)he emphasis was put on fee collection initially, and I think that the departments had to do as good a job as they could to eventually implement the rest of the Policy. But it wasn't put to them in the terms of starting to collect fees only when they had all of the elements in place. I think the revenue was assumed very quickly through the budget procedure."

[T]he emphasis was put on fee collection initially, and I think that the departments had to do as good a job as they could to eventually implement the rest of the policy. But it wasn't put to them in the terms of starting to collect fees only when they had all of the elements in place. I think the revenue was assumed very quickly through the budget procedure.

The Auditor General

This introduces a distortion into the fee-setting process. In the case of voluntary services, such an approach moves fee setting that much farther away from the admittedly difficult marginal-cost ideal. With mandatory services, setting a revenue target loosens the link between user charges and the cost of the service provided. Setting a revenue target and then dividing it into unit costs (to get an average cost — the preferred way of pricing services in government)

[15] User Fees: *Where Does the Buck Stop?*, p. 6.

discourages the development of efficient pricing and contributes to the view that cost recovery is being implemented to generate fees — not to support the efficient use of government resources.

What can result is a situation in which the general public, through general tax revenues and appropriations, is paying too little for a cost-recovery service, and the user of the service paying too much. As the Policy implies, cost recovery should not be used as an excuse to cut revenues.

Cost recovery, in our opinion, is a useful government policy, but programs must be given the resources and the infrastructure they require to ensure the benefits are fully available to Canadians and to clients.

Dann Michols,
Director
General, Therapeutic
Products Programme,
Health Protection Branch,
Health Canada

Mr. Michols told the Committee: "Cost recovery, in our opinion, is a useful government policy, but programs must be given the resources and the infrastructure they require to ensure the benefits are fully available to Canadians and to clients."

Recommendation 9:

The Committee recommends that the government-wide review of user charges examine (1) how well user charges approximate efficient pricing; and (2) whether cost recovery has resulted in underfunding (from general revenues) of cost-recovery sections and overfunding of others. It should address such issues as mandatory user charges, performance standards and the treatment of public/private benefits with the goal of making the Policy more explicit in its requirements. More specific and enforceable guidelines should be developed to aid in the determination of pricing for voluntary and mandatory services.

F. "User Pay, User Say" Argument

Some groups are concerned about the potential for agency capture offered by the increasing reliance on cost recovery by some government departments. According to Mr. Michols, "Other stakeholders may express concern about the integrity of the services delivered, that concern being that if drug evaluation and services are potentially influenced on the basis of, 'He who pays the piper calls the tune.' That is a very real concern within the regulatory regime." According to Health Canada, total cost-recovery revenue for its Therapeutic Products Programme (formed in January 1998 from its Drugs Directorate and the Medical Devices Bureau of the Environmental Health Directorate) amounted to $39.9 million, approximately two thirds of the Programme's total funding.[16]

This is a difficult area, as Mr. Neville told the Committee: "Government program managers must achieve a balance that is responsible to client needs, but does not allow this to undermine the policy basis of their programs. This can

[16] Health Canada, Health Protection Branch, *Cost Recovery in the Therapeutic Products Programme*: An Overview, 20 April 1999, www.hc-sc.gc.ca/hpb-dgps/therapeut/htmleng/costrec.html

never be simple. However, industry representatives have every right to express frustration when agreed upon service levels have not been achieved. This is an area that needs a good deal of attention and will certainly form a key element of our policy review."

Members of the Consumers' Association of Canada remarked to the Committee that, "Civil society, while generally supporting the concept that business and industry should pay a fee for the privilege of operating in Canada, distrusts information paid for by industry and have concerns that paying the government allows them to influence the regulators." (Ms. Hillard)

Talking about the TPP, Ms. Jean Jones (Chair, National Health Council, Consumers' Association of Canada) said, "In many fora over the past two years consumers have expressed their serious concerns that the heavy dependence on cost recovery for funding of the drug-review process — they believe that this dependence is impacting the primary objective of the drug review process, which is to protect the health of the public, by focusing on service to the client. Senior bureaucrats now refer to industry as their clients, reinforcing the impression that they are focusing more on serving industry than protecting consumers."

Senior bureaucrats now refer to industry as their clients, reinforcing the impression that they are focusing more on serving industry than protecting consumers.

Jean Jones,
Chair, National
Health Council, Consumers'
Association of Canada

Professor Bird also saw this as a problem. Taking a non-federal example, he said, "If I'm regulating the taxi industry, my clients are not the taxi drivers or the taxi owners. They're the customers. The analogy is perfect: the clients are not the people you're dealing with directly in most cases. They are in fact the Canadian people and that's why it's critical ... that those groups be always heard."

Ms. Hillard added: "CAC believes that the transparency and accountability of any cost-recovery system is critical to its acceptability to all stakeholders. Business must recognize that the costs they pay are only a portion of the real costs, the rest is still borne by taxpayers. This must be clearly communicated to ensure that regulators are not pressured by those being regulated. It must be clear that they are not just service providers for the regulated."

The Cost Recovery Policy discusses briefly this concern. A question and answer section appended to the Policy states:

> Those expected to pay have a clear right to be consulted on the costs and efficiency of programs instituted on their behalf, as well as on the quality standards achieved by such programs. However, there may be practical limits to this when there are competing policy objectives. Departments and agencies should work as closely and cooperatively as possible with their clients to deliver services efficiently without losing sight of fundamental policy objectives.

The Committee notes that Treasury Board has indicated that it will be listening to all stakeholders in its upcoming cost-recovery review. We also remark that enforcement of the Policy would address the concern over user pay, user say.

The fact that this is a concern indicates that the benefits of theses services are primarily public not private. If they were primarily private, user involvement in the design and implementation of mandatory services would not be a serious public policy issue and would pose no conflict of interest.

[T]here's also the need for some direction on how to avoid the potential for conflict of interest. I think that as there is a greater dependency on fee recovery, a client-provider relationship could be established, and in some areas that may not be entirely healthy.

The Auditor General

This was another area in which the Auditor General urged further discussion. "(T)here's also the need for some direction on how to avoid the potential for conflict of interest. I think that as there is a greater dependency on fee recovery, a client-provider relationship could be established, and in some areas that may not be entirely healthy. So I think there's a need to worry about that aspect as well."

G. Service Improvements

> There seems to be a Treasury Board problem: there was the introduction of these fees seemingly without a firm commitment to meet the performance levels that were implied. (Mr. Jim Keon, President, Canadian Drug Manufacturers Association)
>
> When these fees were implemented, the government committed to making them fair, accountable and transparent. Our experience with cost recovery has not reflected these basic commitments. (Mr. Myers)

In the TPP, drug approvals routinely take almost 600 days, almost twice the promised 355 days.

According to the Policy, providing better service more efficiently is one of the main objectives of user charges. It is clear from the testimony heard by the Committee that in many cases these improvements have not been made. In fact, in some areas, service delivery has actually worsened. In the TPP, drug approvals routinely take almost 600 days, nearly twice the promised 355 days.

Again, the lack of coherent information from Treasury Board makes it difficult to estimate the pervasiveness of service shortfalls. However, based on the testimony heard by the Committee, these shortfalls are important enough to warrant examination and action. Indeed, as Mr. Neville remarked, "Discussions about service standards must occur. They are central to our policy, but they are never going to be simple. There will always be an inherent different concept of acceptable risk between government and the affected industry."

Department officials pointed to a number of reasons for the delays, including a lack of resources linked to cuts to their appropriations and the need to consult and study the impacts of fee changes.

Two points should be considered. First, where an individual or firm must pay for a service, they have the right to know what they are paying for. This includes knowing how long it will take to complete the process. If the service is not delivered as "agreed" to, there should be penalties. Thus:

Recommendation 10:

Where possible, fees should be reduced if service commitments are not met.

Second, if departments or agencies are finding it difficult to fulfil their duties, alternatives should be examined where practical. As put by Mr. Michols, "As industry globalizes, it makes no sense at all that regulators don't globalize at the same time." Though this can present its own problems (what standards should be used, etc.), it is worth exploring.

Recommendation 11:

Other enforcement mechanisms should also be considered such as alternative service providers and the use of international standards. Governments have reformed their approach to regulation by replacing some command and control regulations with market-based regulations.

REGULATORY POLICY

> Another area that ties into this issue quite closely is regulation red tape and paper burden. (Mr. Rob Meijer, Agri-business Policy Analyst, Canadian Federation of Independent Business)

Any attempt to address competitiveness or overall policy effectiveness must consider more than one area of government policy.

Cost recovery is not the only government policy that affects the economy. Any attempt to address competitiveness or overall policy effectiveness must consider more than one area of government policy. Though this Report centres on user charges, much of this analysis can be expanded to include regulatory policy in general. Well-designed and appropriate regulations can have positive effects on the Canadian economy and Canadians' standard of living, but they also impose a cost on businesses and, by extension, Canadians and the economy in general. As an OECD report on regulation notes, "Inappropriate regulations can potentially result in substantial costs or inefficiencies being imposed upon both the sector and the economy as a whole."[17] In this sense, regulations are similar both to taxes and user charges. At the same time, regulations should only be undertaken to correct for market failure, generally following the "publicness" guidelines mentioned earlier.

[17] OECD. *The OECD Report on Regulatory Reform, Volume II: Thematic Studies*, France: OECD, 1997, p. 9.

It makes sense, therefore, that any reform in user-charge policy be accompanied by an examination of Canada's regulatory regime.

Canada, like most OECD countries, has undertaken extensive reviews of its regulatory systems. In the United States, the National Partnership for Reinventing Government, began by Vice President Al Gore in 1993, tackled regulatory review, among other issues, with an aim to simplifying government. By 1995, it had produced recommendations with estimated savings of nearly $70 billion over a five-year period.[18]

However, despite these reviews, the number of regulations in almost all countries continues to increase. There are many reasons for this, including the desire for greater environmental protection. However, more important than the quantity of regulations, though, is the quality of these regulations.

A Regulatory Impact Analysis (RIA) is designed to take into account the cumulative effect of regulations, weighing their pros and cons. A well-designed RIA program helps avoid implementing regulations that are more expensive and less effective than need be.

RIAs face the same problems as user charges: they are very difficult to quantify. Merging qualitative and quantitative analyses can be challenging. As well, the experience in OECD countries has been less than favourable. A survey of U.S. regulations found that half the regulations adopted could not pass a benefit-cost test, even after 15 years of investment in a benefit-cost program. In other countries, the OECD reports that regulations continue to be made without even rudimentary cost analysis.

It is also important that alternatives to regulation be considered. In certain situations, these can prove more effective at a lower cost than regulation. Some alternatives include: information disclosure, economic incentives, tradable property rights, voluntary agreements, self-regulation, risk-based liability, persuasion, performance-based approaches, and economic instruments such as taxes, and tradable permits. The goal is always to achieve a certain objective in the most efficient way possible.

Measuring the impact of regulation is difficult; most studies of regulatory impact seem to be content with noting the cost of regulation, and not its benefits, which are comparatively harder to quantify. Still, the OECD remarks that the quality of regulation in member countries seems to have gone up: "A key contributor to higher regulatory quality has been a shift away from older forms of economic regulation, which rarely result in net social benefits, toward social regulation in the health, safety and environmental areas, which address genuine market failures and have the potential to provide significant net benefits."[19]

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[18] *Frequently Asked Questions about the National Partnership for Reinventing Government (formerly the National Performance Review)*, http://www.npr.gov/library/papers/bkgrd/q-n-a.html.

[19] *The OECD Report on Regulatory Reform, Volume II: Thematic Studies*, p. 232.

The OECD remarks that reviews, impact analyses, and greater consultation with involved parties have increased the quality of regulations, "so that, although there are many new regulations in the 1990s, they are on average better regulations than their 1970s counterparts. That is, regulations delivered better policy results at lower cost."[20]

A. The Experience in Canada

In 1992-93, federal departments and agencies, through internal processes, public consultations and support from the Treasury Board, undertook a regulatory review. As a result of the review, some 835 regulations were revised or eliminated between 1993 and 1998.

Despite the regulatory review, the number of regulations continues to rise. However, while the absolute number of regulations continues to increase, the rate of increase has fallen steadily from its high of 1,392 in 1985 to 676 in 1998.[21] This experience — an overall increase in the number of regulations, but at a lower rate — is in line with the experience of the vast majority of OECD countries.

In January 1993, the Finance Committee released *Regulations and Competitiveness*, which examined the regulatory process, from the delegation of rule-making powers by Parliament to the monitoring and evaluation of existing regulations. Many of the Committee's recommendations are reflected, to some extent, in the current Regulatory Policy. One interesting recommendation that is not calls for the President of the Treasury Board to release an annual accounting of the "Estimated Costs and Benefits of Federal Regulation." As with user charges, the interaction of the costs and benefits of regulations has not been well examined; an annual report such as that called for by this recommendation would go a long way toward giving policy-makers and Canadians a clear view of the debate.

In November 1999 Canada adopted a new Regulatory Policy, replacing the 1995 version of that policy. It transfers responsibility for the Regulatory Policy from the Treasury Board (which remains involved in the regulatory process) to the Privy Council Office; the PCO's Regulatory Affairs Division is responsible for the Policy. Appendix II of this Policy, among other things, mandates:

- Consultations with Canadians;
- That regulations' impacts on the economy be analyzed;
- That regulations only be adopted if their benefits outweigh their costs, and if they are the best alternative;

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[20] Ibid., p. 12.

[21] Registrar of Regulations, Privy Council Office, 1998. Quoted in Fazil Mihlar, *The Cost of Regulation in Canada: 1998 Edition*, Vancouver: The Fraser Institute, 1998. Table 1. www.fraserinstitute.ca/publications/pps/12/

- That systems be in place to manage regulatory resources effectively; and
- That international and intergovernmental processes be respected.

This Committee found substantial inconsistencies with the implementation of Treasury Board's user-charge policy. We therefore suggest that a logical next step would be an examination of regulatory policy.

B. National Partnership for Reinventing Government: An American Example

In the United States, the ongoing National Partnership for Reinventing Government (NPR)[22] provides a possible model for a Canadian re-examination of Canada's regulatory framework. This reform, designed to, "In time for the 21st century, reinvent government to work better, cost less, and get results Americans care about," was centred around, "Providing the best customer service; increasing electronic access to government, or E-Gov; achieving outcomes no one agency can achieve alone; and embedding reinvention in government's culture."

In regulatory reform, it aims to "target our reinvention efforts at those folks who are responsible and want to comply." Specifically, it is designed to accomplish four goals, enunciated in 1995:

- Cutting obsolete regulations;
- Rewarding results, not red tape;
- Creating grass roots partnerships; and
- Negotiating, not dictating.

Later that year, President Clinton called on departmental agencies to allow firms that have been fined to apply these fines to fixing their problems; and to reduce reporting burdens by doubling the time required between reports; i.e. annual reports could be given biennially.

This American effort involves a wide range of activities:

- Sharing best practices across agencies;
- Breaking down barriers between agencies;
- Pushing plain language and compliance assistance tools;

[22] Web site: www.npr.gov.

- Building partnerships with the private sector and communities;
- Putting information technology to work; and
- Changing the way progress is measured.

The U.S. claims to have had some success from this initiative. According to the NPR, government agencies are:

- moving away from "command-and-control" methods of encouraging compliance;
- measuring customer satisfaction and incorporating service and results measures into performance plans;
- focusing on helping firms and industries comply with regulations; and
- encouraging private sector to get involved in the rule-making process earlier rather than later.

For instance, voluntary partnerships instituted by the Environmental Protection Agency, which encourage and recognize environmentally friendly actions, resulted, in 1998, in savings of $US 3.3 billion; the elimination of 7.8 million tonnes of solid waste, prevented the release of 80 million metric tonnes of carbon dioxide, and saved nearly 1.8 billion gallons of clean water. The Consumer Product Safety Commission has developed a Fast Track Product Recall program that provides companies with a streamlined product recall process when firms recall their products voluntarily. It estimates that the percentage of products returned under this program is nearly 60%, against about 30% under a traditional recall program.

Finally, the Food Safety and Inspection Service has instituted a science-based, preventative program for ensuring that meat and poultry are safe. By putting "the responsibility for food safety into the hands of food producers, rather than into the hands of government inspectors," salmonella has been reduced in 300 large plants by nearly 50% in chicken products, 30% in ground beef and 25% in pork products in January 1998.

As this Committee has already noted, this kind of openness, clarity and responsiveness is what it has found to be lacking in the implementation of user charges in Canada. Further, in keeping with this Report's recommendations, the government should consider implementing a "regulatory budget," which would detail estimates of the total cost of regulation, including enforcement and compliance costs, and a risk-benefit analysis. As was suggested by the Finance

The government should consider implementing a "regulatory budget," which would detail estimates of the total cost of regulation, including enforcement and compliance costs, and a risk-benefit analysis.

Committee in 1993, an examination of Canada's regulatory structure would help determine whether Canada's previous attempts at implementing sound regulatory policy have been successful.

Recommendation 12:

That the government set up a red-tape commission in order to evaluate and streamline regulations. It would conduct an examination of existing regulations to determine if they are still appropriate. Those that are not would be re-written, or deleted entirely. Further, the commission would establish guidelines for the implementation of future regulations. It would be guided by the goal of reducing the regulatory burden on the Canadian economy.

CONCLUDING COMMENTS: CONTINUING THE DIALOGUE

Traditionally, user charges have played a minor role in the financing of government programs. As a result, the link between individual programs and their performance, efficient construction and those served by the programs has been weak. As Professor Bird and others told the Committee, user charges have helped make people aware of the cost of "free" government services. On the other side, as the Auditor General has noted, cost recovery has forced departments and agencies to think in terms of controlling expenditures to deliver the best, most efficient service possible.

Most importantly, the implementation of user charges has opened up a dialogue among government, individuals and businesses who are the direct beneficiaries of these cost-recovery programs, and the Canadians served by licensing and regulatory regimes.

This Committee views our report as a contribution to this dialogue. Our examination of the content and implementation of the current Cost Recovery and Charging Policy has found many ways in which it could be improved. This is not surprising, since designing sound user charges is difficult enough in theory. Implementing them in the midst of complex real-world happenings is even more so.

Collecting and making available to Canadians timely and detailed information on cost-recovery programs will help in the evaluation of the Cost Recovery and Charging Policy generally and individual programs specifically. Given the current decentralization of the program, this is very difficult to do. The required increased central coordination, combined with better parliamentary oversight and an independent dispute-resolution mechanism, will

provide Canadians with the accountability they deserve.

The Policy itself is generally sound. In keeping with the need for greater accountability and consistency, most of the Committee's recommendations are centred on making the Policy more explicit and enforceable. Tackling the issue of how to define public and private benefits, for instance, will be a difficult but necessary step toward achieving a consistent, clear policy. And it is preferable to the present situation, in which 47 departments and agencies each have their own definition of public/private benefits, to say nothing of 47 different dispute-resolution processes, or 47 different definitions of business impacts.

This Committee believes its recommendations will help strengthen the Cost Recovery and Charging Policy.

The federal government is responsible for creating an environment in which individuals and firms can flourish. To this end, a solid user-charge policy is only one part of a positive economic climate. Like user charges, a badly implemented regulatory regime can have a negative effect on individuals and business. It is this Committee's hope that this Report will both continue the dialogue on user charges and begin one on regulatory reform, all with an eye to making government more responsive to Canadians.

PART II:
CASE STUDIES

The major difficulty in undertaking a government-wide study on cost recovery is the poverty of information available. Data and program information are spread out over dozens of government departments and agencies, in hundreds of programs. In order to get as clear a picture as possible on the status of cost recovery, this Committee concentrated on the health, agriculture and agri-food, and marine services sectors, where user charges play an important role. These studies, in which time and again the same concerns arose, formed the basis of the recommendations found in Part I of this Report.

CASE I: HEALTH CANADA'S THERAPEUTIC PRODUCTS PROGRAMME

Among government departments, Health Canada has seen the second-largest percentage increase in user charges over the past five years. Since 1994-95, user charges have risen 118%, from $27.7 million to $60.4 million in 1998-99. For the first time, many mandatory services like drug testing were subjected to user charges.

According to Mr. Dann Michols (Director General, Therapeutic Products Programme, Health Protection Branch, Health Canada), user charges cover anywhere from 20% to 80% of the cost of the Health Canada activities for which fees are charged, with the balance coming out of appropriations. Currently, there are cost-recovery initiatives in the following programs: the Therapeutic Products Programme; Environmental Health Program; Pest Management Regulatory Program; Occupational Health and Safety Program; Medical Services Program; Food Safety Program; and the Hazardous Materials Information Review Program. In the Therapeutic Products Programme (TPP), user charges cover about two thirds of program cost.

Mr. Michols told the Committee similar industrialized countries, "including the United States, the United Kingdom, the European Union, Australia and New Zealand, all ... have some form of user fee policy in place and in some cases their regulatory programs are funded 100% by revenue as opposed to government appropriation."

Cost recovery, according to Mr. Michols, has helped achieve the goal of making government more businesslike: "It also, I think, had a major impact on the mindset of the scientists and the regulators within the program in that it forced them into thinking about the regulatory process as being a managed process, as there being clients at the end of the process who had legitimate needs. That also was an incentive to increase the productivity."

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Dann Michols

It is, however, very difficult to make government businesslike when the incentives for such behaviour do not exist. For example, as cost recovery was implemented in a world of general program reductions, what guarantee does a department have that efficiency gains would not just lead to further funding cuts? When a fee is for a mandatory service without competing suppliers, what aspect of user charges would lead to a more businesslike mindset?

For this report, the Committee looked at the TPP, specifically at the experiences of Canada's brand-name and generic drug manufacturers. Beginning in 1995, the TPP has charged five different drugs-related fees: fees for the authority to sell drugs, drug evaluation fees, drug master file and export certificate fees (both of which started in 1996), and drug establishment licensing fees (which began in 1998). Together these fees totaled $33 million in 1998-99, down from $37 million in 1997-98.

TABLE I:

DRUGS AND HEALTH USER CHARGES

Fee Description	**1994-95**	**1995-96**	**1996-97**	**1997-98**	**1998-99**
			$ million		
Drugs Import/Export Licences	0	0	0.1	0.2	0.3
Drugs Product Master File	0	0	0.07	0.08	0.09
Drug Establishment Licences	0	0	0	0	3.2
Drugs Program Cost Recovery Project	2.5	7.1	6.7	8.5	6.9
Drug Evaluation Fees	0	3.5	17.8	28.3	22.5
Total Drugs Charges	**2.5**	**10.6**	**24.7**	**37.1**	**33.0**
Total Health Charges	**27.7**	**35.5**	**49.6**	**63.2**	**60.4**

Source: Treasury Board Secretariat

Health Canada is working toward revising and bettering the cost-recovery program through a variety of initiatives and studies. These include the TPP Phase IV Review, which seeks to evaluate the impact of cost recovery in TPP on businesses of all sizes, consumers, affected sectors, and governments and regulators themselves. It will examine both benefits and costs to regulation. As well, the Health Protection Branch has conducted a wealth of studies and consultations on business impacts.

Mr. Michols contended that the transition to user charges has been largely successful, though difficult, including the problems of "having to manage a revenue-dependent operation within the constraints of the public service which is oriented towards an appropriations-based operation."

In setting fees, Mr. Michols told the Committee that both health and economics played a role: "The environment in which Canadian industry and Canadian-based industry must operate, is a very real factor in our environment. That said, our mission is to protect the health and safety of Canadians. It's to ensure that the drugs that are available to Canadians are safe, effective and of high quality. That's job one."

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Dann Michols

Further, seemingly in contrast to the Treasury Board Policy, a main role of user charges in the health portfolio is the generation of revenues.

PROBLEMS WITH IMPLEMENTATION

A. Service Commitment Not Met

Both the brand-name association, Canada's Research-Based Pharmaceutical Companies (Rx&D), and the generic drug group, the Canadian Drug Manufacturers Association (CDMA), were not opposed to the principle of user charges — both, in fact, had been consulted extensively on the set-up of the various fees. In keeping with taking fee-payers' needs into account, TPP introduced performance standards for submission review processes that were internationally competitive with leading drug regulatory agencies.

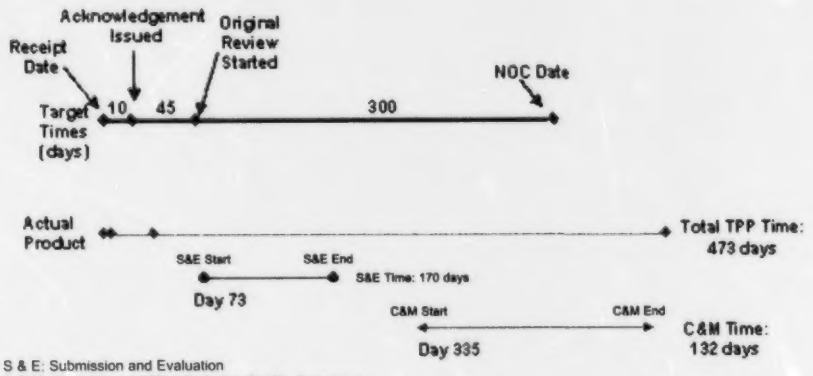
According to Mr. Jim Keon (President, CDMA), "We agreed to the fees to be paid because we were assured that there would be a real effort from TPP to improve the time it took to review generic drug submissions, ensuring faster notices of compliance and timelier access to the market."

These targets have not been met. The target chosen for brand-name drugs was 355 calendar days. However, according to Rx&D's John Stewart (Executive Vice-President and General Manager, Purdue Pharma), approvals now average around 591 days. It should be noted that this is down significantly from a high of 1,142 days in 1992, though it is both significantly higher than the promised 355 days and compares unfavourably to international regimes in the United Kingdom, the United States and Sweden.

According to Rx&D, brand-name approvals now average around 591 days, significantly higher than in the United Kingdom, the United States and Sweden.

The Committee heard that while total approval time is averaging almost 600 days, delays are the result of drugs spending a long time in the queue waiting to be processed, due to a lack of personnel.

Comparison of Performance Targets Against Actual Experience of One Brand-Name Drug



S & E: Submission and Evaluation
C & M: Chemistry and Manufacturing Quality Assurance
NOC: Notice of Compliance
Source: Rx&D

Drug evaluations consist of two parts: submission and evaluation, and chemistry and manufacturing-quality assurance. While these could be done simultaneously, as the above chart shows, at present they are being done consecutively, with significant waiting periods between the two steps. As the above chart also shows, if the tests were done simultaneously, TPP would have no difficulty in meeting its targets. While acknowledging this, Mr. Michols claims a lack of appropriations prevents this from happening.

Generic drugs face a similar situation. Approvals were promised in 225 calendar days, with another 195 days if the submission needed to go to a second review because of some deficiency. Performance, which initially improved in 1995 and 1996, has since deteriorated, according to the CDMA. According to Mr. Keon, "The actual performance, as reported in TPP's annual report on performance in 1999, was 458 days on average for first reviews for generic submissions, which is more than twice the performance target. We understand that the actual time for reviewing a generic submission is approximately 30 days, and yet it takes 458 days to have them reviewed. The rest of the time is spent in the queue or in down time."

Rx&D contends that as a result of TPP's longer processing times, drugs are taking longer to get to Canadian patients. On the economic side of the ledger, it ends up taking longer for industry to be able to earn a return on its research and development. Indirectly, since companies can get their drugs approved more quickly in larger markets, Canada loses out on investment, manufacturing and employment opportunities. And, of course, Canadians are denied access to newer and better drugs during this delay. No safety benefit results from an

excessively slow drug approval process: this lengthy process is not due to careful review of applications, but rather to the bad management of that process.

Longer approval times for generic drugs impose a cost on the health system, as patients in the interim have to rely on pricier brand-name drugs.

For generic drugs, which cost up to 50% less than brand-name drugs, the longer drug approval period lengthens the time it takes to get less expensive drugs to market. This, in turn, imposes a cost on the health system, as patients in the interim have to rely on pricier brand-name drugs. Additionally, the CDMA calculates that since 1995, overlong approval times have resulted in lost sales totalling $250 million, between $100 and $140 million in lost savings to consumers and insurance plans, $57 million in lost investment and research and development, as well as about 140 fewer jobs created. In addition, approximately 75 fewer generic drug submissions were generated.

This is only one of the promises of cost recovery that has not been delivered. In the Regulatory Impact Analysts Statements attached to the Drug Evaluation Fees Regulations (JUS-95-297-02), the government made the commitment that: "Once future standards have been developed priority will be given to link them to the fee schedule in such a way that fees payable will be reduced for submissions which have not been processed within times defined by the standards."

One of the stated goals of the Cost Recovery Policy is that fees should be used to improve service by making government employees aware of the needs of the people using their services. "Charges also result in better and more client-oriented services, if for no other reason than the fact that users demand value for their money. Adopting client suggestions to improve service delivery and efficiency is a prime example of responsive government." Regarding mandatory services, it continues: "there may be scope for tailoring the service to better suit the operations of the clients it serves."

Fees can only provide for better services if there is some mechanism by which clients' demand for better services can be effectively articulated. Since the User Charge Policy lacks an effective grievance-resolution mechanism, clients possess few levers to gain better services.

The Policy also presents a conundrum for policy-makers. As it turns out, user charges have become an important source of revenue for certain programs. At the same time, fees payable are to be linked to the achievement of standards. If the standards are not met, fees are to be reduced, lowering revenues and reducing the ability of the agency or department to deliver measures that benefit Canadians at large.

When standards are not met in a world of competitive markets, clients can seek out alternative suppliers. This is not the case when government is a monopoly supplier of mandated services. The checks and balances and incentive structure that exist in a competitive market do not exist in government. It is therefore a much greater challenge to incite businesslike behaviour in a government department than it is in a firm, even in a world of user charges.

B. Fee Set-up

According to the Cost Recovery Policy, user charges are to be seen as a way to improve governmental efficiency and not as a revenue generator. It is worth remembering, though, that the Cost Recovery Policy has its genesis during a time of governmental cutbacks, with programs facing budgetary reductions.

In the TPP, user charges have in fact been used to make up the appropriations lost. According to the Business Coalition on Cost Recovery, "In April 1995, the TPP provided to industry a detailed costing of their program, including a breakdown of private/public benefit by activity. While it was unknown what methodology was employed to derive the level of private benefit, overall the assessment indicated a 50/50 share of program costs ... . However, the final fees were determined by applying a 1.35 'upscale' factor to costs in order to generate the necessary revenues for the program."[23]

Regarding the set-up of fees, Mr. Michols told the Committee, "We were starting from the premise that if we were losing 50% of our appropriations through the Program review then we needed to attempt to raise at least that much through cost recovery if we were going to maintain the current level of productivity. And, then as I've indicated, we've actually doubled the productivity in the same period of time." In fact, he stated, it is this lack of appropriations that is keeping submissions from moving through the approval process at the promised rate.

He was supported in this by Mr. Stewart: "It (the TPP) is a complex department. It does have a lot of activities ... that are unrelated to the review and approval drug submissions, but very important. I believe some of those areas have in fact increased, and I do not believe that their appropriations or their budget, their overall funding, have increased in a commensurate fashion."

Without commenting on the optimal funding level of these or other programs, it seems clear that this approach contradicts the spirit of the Cost Recovery Policy. Namely, it ignores the principle that user charges should be based on (a) cost, and (b) the benefit received by whoever pays the user charge. In this case, what could result is the individual or firm subsidizing the benefit received by the general public. Just as firms should pay their "fair share" for services received, so should the public provide an appropriate level of funding through general tax revenues. Government appropriations should not be directed away disproportionately from programs with user charges into programs that do not have user charges attached. By introducing pre-set revenue targets into the fee-building process, attempts at achieving equity or efficiency are made more difficult.

The key to the success of any user-charge program is the business impact analysis, with the rule being if costs outweigh benefits, the fee should either be changed or scrapped. Here, too, Health Canada found it difficult to carry out the Policy, Mr. Michols related that business impact analyses were "of an uncertain

[23] *User Fees: Where Does the Buck Stop?*, p. 28.

quality, mostly anecdotal. Departments and agencies typically have no legal authority to request sales data, rendering it difficult to assess economic impacts of proposed fees on one company much less on an entire industry."

C. Role of Treasury Board

In setting up its cost-recovery program, the TPP seems to have hit two major problems: building a cost-recovery program from scratch in a bureaucratic environment while cutting costs, and a lack of direction from the Treasury Board, the overseers of the Policy. Mr. Michols commented on the difficulty of "working within the ambit of a broad Treasury Board policy but without detailed guidelines and little direction on how the various initiatives should be introduced."

There is also the general sense that the Department does not have enough support from Treasury Board: in other words, while individual programs are working with cost recovery, government at large has not adapted to support them. According to Mr. Michols: "Implementation has been a problem. ... (M)uch of that problem has been that in setting those principles (of cost recovery), and in expecting program managers to develop targets and to measure performance, the infrastructure within the government to support the managers who are undertaking that has not been there."

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Dann Michols

Indeed, this refrain echoed in the voices of many roundtable participants. Both industry and departmental officials seem to agree that problems with the Policy are located in Treasury Board, which is not enforcing the Policy adequately, and which is itself not specific enough. If Treasury Board were actively enforcing the Policy, it would have looked into the revenue basis of these fees. If the Policy were more specific, it would be easier to define public/private interests and to make sure business impact analyses from industry were treated consistently. Such a policy could also deal with non-implementation of user-charge agreements such as overly long waiting times.

For instance, Mr. Michols said that users' expectations are unreasonably high due to the implementation of user charges, or that they simply do not understand what the user charge pays for. As an example, he remarked, "It should be noted that the establishment of licensing fees are promulgated under the rights and privileges power of the *Financial Administration Act* (FAA), not the services provision, and, as a result, specific services are not required to be associated with the fees." While this might be technically true of the FAA, the issue at hand is the User Charge Policy of the government, where fees are to be linked to services.

There seemed to be frustration among industry about who to go to in order to have disputes about expectations, service, and the amount of user charges arbitrated. Treasury Board is generally seen as ineffective, and appealing to a department's minister about that ministry's program places the ministry in a conflict of interest.

D. Bureau of Veterinary Drugs

Compared to other countries, the fees charged by the BVD are excessive.
Jean Szkotnicki

A similar situation exists in Health Canada's Bureau of Veterinary Drugs (BVD), according to industry witnesses. Ms. Jean Szkotnicki (President, Canadian Animal Health Institute) remarked that, "Compared to other countries, the fees charged by the BVD are excessive. Approving a new animal drug in the United Kingdom costs on average — and these are food and companion animal estimates — about $30,000. In Australia it costs just over $20,000. In Canada the fee for the same service is more than $54,000. The Canadian cost-recovery program for veterinary drugs is the most costly in the world relative to market size. And in the United States, our largest agricultural competitor with an agricultural market 10 times greater than Canada's, there is no charge to review new veterinary drugs or biologics." She added that these higher fees act as a disincentive to product registration and innovation.

As with the TPP, the BVD service performance has worsened since cost recovery. According to Ms. Szkotnicki, it now takes an average of 926 days to approve a veterinary drug, compared to 427 days in 1995, before cost recovery was instituted, and much above the 180 days promised upon the beginning of cost recovery. Despite these problems, the Committee was told that the BVD has decided not to participate in Health Canada's cost-recovery review.

CASE II: AGRICULTURE AND AGRI-FOOD

In the agri-food sector, user charges collected by the federal government are not new: for over 60 years, farmers have paid grazing rights to the Prairie Farm Rehabilitation Administration (PFRA) for the use of its community pasture lands; and, for nearly 90 years, the Canadian Grain Commission (CGC) has charged fees for its export grain inspection services.

The three main entities in the agri-food sector that collect user charges are Agriculture and Agri-Food Canada (AAFC) itself, the CGC, and the Canadian Food Inspection Agency (CFIA). User charges in the agri-food sector totalled $127.0 million in 1998-99. These figures rank the agri-food sector seventh among federal government sectors that, together, collect $3.706 billion in user charges. By agency, in 1998-99 the CFIA collected $49.7 million in user charges for inspection services to food producers, and the CGC recovered $36.1 million in user charges, mostly for the inspection and weighing of grain destined for export. AAFC collected the difference.

TABLE II:

DEPARTMENT OF AGRICULTURE AND AGRI-FOOD COST RECOVERY

Department/ Agency	# of programs	1994-95	1995-96	1996-97	1997-98	1998-99	1994-99
				$ million			% change
Agriculture and Agri-Food	24	36.1	43.0	45.2	42.8	41.2	14.0
Canadian Food Inspection Agency	19	20.8	27.3	34.1	42.4	49.7	138.9
Canadian Grain Commission	1	56.6	46.6	42.8	56.4	36.1	-36.3
Total		**113.5**	**116.9**	**122.1**	**141.6**	**127.0**	**12.4**

Source: Treasury Board Secretariat

User charges are a source of considerable concern in the agri-food sector. Agricultural producers have opposed the way these charges were implemented and criticized their cumulative impact. In 1998, AAFC carried out a study on the cumulative impact of federal user charges affecting the agri-food sector. The authors of this study, testifying before the Standing Committee on Agriculture and Agri-Food, concluded that the impact varied by production sector, and that user charges reduced net operating income by from virtually zero to 3.4%.[24]

In all AAFC agencies, user charges have been frozen until 2002, except for the CGC, where fees will be frozen until 2004.

SOME POLICY CHALLENGES

A. September 1999 Report by the Auditor General

In its September 1999 examination of AAFC's cost-recovery programs, the Office of the Auditor General found them to be severely lacking in many areas.

According to Auditor General Denis Desautels: "Each organization needs to improve its costing capability in order to improve its management of user charges and enhance public confidence. While the Treasury Board Secretariat and my office have emphasized the importance of good costing systems, we found a reasonable costing system in only one program area."

Each organization needs to improve its costing capability in order to improve its management of user charges and enhance public confidence.

The Auditor General

[24] *Impact Of Selected Federal Cost Recovery Initiatives On The Agri-Food Sector*, AAFC, September 1998.

Further, the Auditor General told the Committee, "service standards are not widely used. Third, the organizations need to improve their assessment of the potential impact of fees. Impact assessments that we reviewed were imprecise and contained little information that would help the reader understand the fees' expected impacts."

"Fourth, formal appeal processes were either not well known or not in place. Fifth, the organizations need to improve the quality of information on user charges that is made available to parliamentarians and to the public. This includes reporting on service standards achieved, revenue raised, the ways in which user fees have helped the organization meet its objectives and the means of obtaining more detailed information on individual fees."

"Finally, our audit found that these organizations have often viewed user charges primarily as a means of generating revenue."

Regarding dispute resolution, the CFIA and other AAFC agencies said they did have programs in place, and even if these did not find favour in the Auditor General's eyes, "the Policy of 1997 in no way defines what a dispute mechanism is. As such it is very much in the eye of the beholder." (Mr. Jean Chartier, CFIA Vice-President, Policy and Regulatory Affairs) This suggests that the policy should be more explicit in its requirements, as this Committee has recommended.

Mr. Desautels remarked that, "according to the people that we talk to, the producers, they weren't well aware that it existed. So while it is there, it doesn't seem like everybody knows that it's there and making proper use of it."

On the positive side, the Report found that AAFC and its agencies had made progress in management and consultation processes. The shifting of beef grading to a not-for-profit private firm was cited as a positive cost-cutting measure. The OAG also noted that the AAFC was also the first department to undertake a study of the cumulative effects of its fees, a step that the Committee would like to see imitated in all other departments.

However, taken together, the Committee can only conclude that Treasury Board's cost-recovery Policy has not been completely implemented. While the Committee is heartened by AAFC and its agencies' statement to this Committee and the Standing Committee on Agriculture and Agri-food that they are going to address the Auditor General's concerns, the Committee notes that their problems are similar to those faced by Health Canada. This further reinforces the Committee's contention that implementation problems with the Cost Recovery and Charging Policy are widespread, and must be addressed at the source.

B. Small-Business Burden

Cost-recovery programs that do not take into account differences among firms can have a disproportional effect on small business. According to the Canadian Federation of Independent Business (CFIB), a survey of their agri-business members found that user charges at all levels are a problem. According to the Mr. Rob Meijer (Agri-business Policy Analyst, CFIB), "flat or capped rates penalize smaller operations because these fees represent, in percentage terms, a much higher share of their sales or revenue. In this regard, smaller operations do not have the ability to always pass on or spread out the increased expense of governments much like big businesses, leaving many smaller operations at a serious competitive disadvantage."

According to the Canadian Federation of Independent Business (CFIB), a survey of their agri-business members found that user charges at all levels are a problem.

Mr. Meijer also made explicit the link between user charges and regulation. Like user charges, regulations impose a cost on the regulated, in time and money. He mentioned the example of an agri-business, "who recently stated that they are ... subject to a drawback tariff on imported polypropylene bags. This amounts to a cost of $35,000 per year in fees, and apparently another $10,000 in red tape to apply for a refund."

"For just over half of our agri-business members, an average of three or more hours per week is required to satisfy government. In the course of one year, this amounts to a minimum of 156 hours of business productivity — nearly a month of a regular salaried employee's time. ... Overall, this burden has been found to weigh more heavily on smaller operations as they do not have the spare resources, time, employees or readily available information to satisfy government's demands."

For just over half of our agri-business members, an average of three or more hours per week is required to satisfy government. ... This burden has been found to weigh more heavily on smaller operations as they do not have the spare resources, time, employees or readily available information to satisfy government's demands.

Rob Meijer, Agri-business Policy Analyst, CFIB

As in other departments, producers and consumers are affected through direct and indirect costs, and the availability of products. According to Mr. Garth Whyte (Senior Vice-President, National Affairs, Canadian Federation of Independent Business), farmers are hit by direct and indirect costs. "One, they're hit with direct fees, and two, they're hit with indirect costs, which they can't pass through. If fees are increased on chemical or whatever, those fees can be passed on, but the farmer can't pass them on. That's why, in our report, especially during the farm income crisis where 75% said the import costs were a big deal — and tax burden — the fees hit two issues: they hit as a tax and they hit as indirect costs or import costs, and the farmers just can't pass that on."

Ironically, by imposing a cost on farmers, user charges can stymie the best intentions of governments. According to Mr. Whyte, the CFIB has suggested that the grants given to farmers to help combat the farming crisis are almost completely offset by the fee regulatory burden at the provincial and federal levels.

According to the CFIB, the grants given to farmers to help combat the farming crisis are almost completely offset by the fee regulatory burden at the provincial and federal levels.

Ms. Szkotnicki, President of the Canadian Animal Health Institute, which represents manufacturers of pharmaceuticals, biologicals, feed additives and animal pesticides for agricultural and veterinary medicine use, remarked that the promised drug-approval times in the CAHI have not been met. This has a real cost:

> A leading-edge vaccine for food animals, which was developed by a small Canadian company, was submitted to Canadian and U.S. regulators at the same time. The vaccine was approved in the U.S. within three months — and remember, this was submitted by a Canadian company. In Canada the approval process took over 24 months, even though the maximum response time for these submissions is supposed to be four months. During this 20-month delay, sales of the vaccine in the U.S. $4 million U.S. The delay in registration in Canada cost the Canadian company 52% of the revenues it forecast from vaccine sales in this country. This meant less money for job creation and R&D in Canada.
>
> In addition to these direct costs, the delay also imposed additional costs to the livestock sector. Because the vaccine is designed to be injected subcutaneously, i.e. under the skin, as opposed to in the muscle, a major benefit was that this product reduced the amount of meat loss resulting from trimming the carcass around the injection site. The delay in approving this vaccine cost the cattle industry over $28 million annually, it's estimated, because of more trimming than would otherwise have taken place.

C. The Pest Management Regulatory Agency

Though it is part of Health Canada and not AAFC, the Pest Management Regulatory Agency (PMRA) is directly involved in the agricultural sector. In its examination of AAFC, the Committee also heard evidence of problems with the PMRA.

TABLE III: PEST MANAGEMENT REGULATORY AGENCY
TOTAL EXPENDITURES, INCLUDING REVENUES FROM COST RECOVERY FEES

	1995-96	1996-97	1997-98	1998-99	1999-2000 forecast
			$ million		
Revenues from cost recovery fees	0.3	0.3	7.5	7.8	8.5
Total Expenditures	21.5	24.8	24.8	26.7	28.3

Source: Treasury Board Secretariat, Standing Committee on the Environment and Sustainable Development. Report 1, *Pesticides: Making the Right Choice for the Protection of Health and the Environment.*

Note: There was no cost-recovery revenue in 1994-95

In the PMRA, fees mainly cover registrations of pesticides. Ten percent of the fee is paid when the application is submitted, 25% when it is accepted for preliminary review, and 65% when it is accepted for evaluation; in other words, all fees are paid before inspection, even if the product is never registered. Specified fees are charged for each component of the examination process. Fees are reduced in some cases, to account for low volume or niche products, and some applications are exempt from fee payment.[25]

Discussing the PMRA, Mr. Whyte agreed with the assertions of the Auditor General regarding the lack of an appeal process. He also pointed to a more fundamental flaw: that there is a conflict of interest in appealing fees to the organization that is charging the fees.

Industry witnesses told the Committee that the Auditor General's observations on the AAFC also applied to the PMRA. The Crop Protection Institute, which represents manufacturers, developers and distributors of agriculture, forestry and pest-management chemicals and biotechnology, has found that cost-recovery guidelines are the victim of inconsistent interpretation and enforcement. For instance, firms must pay to have pesticides approved by the PMRA, yet "Canadians are allowed to consume produce from elsewhere in the world where the product has been used." What, then, is the threat that the PMRA is protecting against? The Institute also told the Committee that business impact tests, a vital part of cost recovery, were either discredited, or left incomplete or undone. (Mr. Milne, Crop Protection Institute)

Firms must pay to have pesticides approved by the PMRA, yet Canadians are allowed to consume produce from elsewhere in the world where the product has been used. What, then, is the threat that the PMRA is protecting against?

Mr. Milne also commented that cost recovery at the PMRA has suffered because of the way it was implemented. "Cost recovery was imposed on the PMRA at the same time the agency was inventing itself from portions of four different federal departments. Effectively, the creation of the PMRA was a

[25] House of Commons, Standing Committee on the Environment and Sustainable Development. First Report, *Pesticides: Making the Right Choice for the Protection of Health and the Environment*, 2nd Session, 36th Parliament, 16 May 2000.

The imposition of cost recovery at the PMRA during its inception, when there was no historical data for any of the agencies processes, created the challenge of attempting to recover costs which that effectively unknown.

Charles D. Milne

merger, experiencing all the interpersonal and locational adjustments inherent with change and the beginning of something new. The imposition of cost recovery at the PMRA during its inception, when there was no historical data for any of the agencies processes, created the challenge of attempting to recover costs that were effectively unknown."

The Finance Committee is not the only committee concerned with cost recovery. In its study of pesticide regulation, the House Standing Committee on the Environment and Sustainable Development expressed concern that cost recovery was causing difficulties for the department. Specifically, it worried that the reliance on fees was causing the PMRA to concentrate on fee-generating activities to the exclusion of other important programs. Further, it expressed concern that cost-recovery fees present a "possible disincentive to the registration of safer pesticides."

While noting that, "The Committee has not had the opportunity to study the issue of cost recovery more closely," the Standing Committee on the Environment and Sustainable Development did reach the following conclusion:

> In the opinion of the Committee, it is critical that the impact of the cost-recovery fees on the registration of safer and more efficacious products be assessed forthwith. ... If cost recovery fees are discouraging the registration of such products (safer pesticides), corrective action must be taken as soon as possible.[26]

REASONS FOR PROBLEMS

According to both industry and departmental witnesses, cost recovery suffered in its implementation. User charges were introduced in the PMRA and at the CFIA as each organization was being created out of mergers of other government agencies. According to Mr. Chartier, the creation of a new agency, in his case the CFIA, led to a delay in implementing a dispute-resolution mechanism in his agency, though one is now in place.

Further, the Auditor General suggested to the Committee that, in contrast to the Cost Recovery Policy, user charges in the CFIA were intended primarily as revenue generators, as cost recovery was implemented at a time of sharp cutbacks.

[26] Ibid.

The September 1999 Auditor General's report states:

> The food production inspection branch had little time to implement its fee structure as the funding voted by Parliament had assumed that user charges would be in place and would generate the planned revenue. ... The fiscal pressure continued after the agency's creation since it was expected to make the delivery of inspection services less costly to the federal government. Revenue from user charges was needed immediately and identifying areas to reduce or avoid costs had secondary priority.[27]

This reinforces the point made earlier that departments and agencies should look to user charges for market discipline, not as revenue generators. From the government's side, this also requires that cost-recovery programs be adequately funded.

CASE III: CANADIAN COAST GUARD MARINE SERVICE FEES

It is often asserted that user charges are taxes by another name. While this is not the intent of the Policy and is not generally true, a strong case can be made that, as presently constructed, some of the Marine Service Fees charged by the Canadian Coast Guard as part of the Department of Fisheries and Oceans are in fact taxes.

Marine Service Fees (MSFs) are charged in two areas: navigation services (e.g. buoys, radar, navigation systems, traffic services — routes and other traffic controls), and icebreaking services. They were introduced in June 1996 "to recover a portion of the cost of delivery aids to navigation and vessel traffic service to commercial shipping. Icebreaking fees were deferred that year to give industry time to prepare for the fees introduction and an economic impact study was carried out by private sector consultants" (Mr. John Adams, Commissioner, Canadian Coast Guard, Department of Fisheries and Oceans). Icebreaking fees were finally introduced on 21 December 1998, reduced 50% from their original proposed level.

In 1998-99, navigation fees totalled $26.7 million, representing 30.8% of the total cost of the service to commercial shippers. The full cost of all marine services, in 1996-97, was $260.7 million. Icebreaking fees recovered $13.3 million out of a total $76 million for icebreaking services to commercial ships. The total cost of all icebreaking services in 1996-97 was $163.5 million.[28]

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[27] *1999 Report of the Auditor General*, Chapter 11, Insert 1, "Status and Decisions Facing Each Organization."

[28] *User Charges: Where Does the Buck Stop?*, p. 43.

TABLE IV:

MARINE SERVICE FEES, CANADIAN COAST GUARD

	1994-95	1995-96	1996-97	1997-98	1998-99
			$ million		
Marine Services Fees	0	0	17.0	26.9	30.0

Source: Treasury Board Secretariat

These numbers and categories from Treasury Board do not correspond to other data possessed by the Committee, for example those provided by the BCCR. This demonstrates the difficulty in assessing the extent and scope of user charges in Canada.

According to Mr. Adams, "These cost-recovery fees are intended to shift a portion of the costs of delivering commercial marine services from the general taxpayer to those who benefit from the service thereby regulating demand and obviously recovering costs."

In April 1998, the Minister of Fisheries and Oceans announced several modifications to the marine services fee program. These included the capping of fees for three years, improved consultation, the setting up of an independent fee dispute mechanism, a Treasury Board accumulative economic impact study, a regional approach to fee setting and finally the introduction of an icebreaking fee. At present, MSFs are in the second year of a three-year freeze.

PROBLEMS WITH THE FEES

Marine transportation is a highly competitive field that affects iron ore, grain, and other commodity producers. As such, MSFs have the potential to affect significantly the costs and ability to compete of producers and shippers. Mr. Adams told the Committee that a Coast Guard business impact study found that the present fees, which generate about $33 million, would have less than 1/10 of 1% of the value of the commodity shipped.

In 1995 the Standing Committee on Transport published its National Marine Strategy. It recommended that: "No national cost-recovery program should be implemented until Coast Guard has clearly identified its cost for services, the future level required, and demonstrated that it has its costs under control and down to the lowest-cost operation possible."[29]

According to voices from the shipping industry, these commitments have not been met. Costs for services are unclear, while the Coast Guard has not become more efficient.

[29] House of Commons, Standing Committee on Transport, *A National Marine Strategy. May 1995, http://www.parl.gc.ca/committees352/port/reports/03_1995-05_p/port-03-cov-e.html.*

However, according to Mr. Adams, the Coast Guard has seen significant reductions. "For example, we reduced our marine control and traffic services centres from 43 centres across the country to 22. We reduced our personnel resources by about 1,400 people. We reduced our fleet from 189 ... to 106. ... So all of those things have added up to somewhere between 20% to 30% reduction in cost."

Though the Coast Guard says it has consulted actively with commercial groups, industry has complained about inconsistent consultation. While a current agency-industry panel has yielded results, including better deployment of the Coast Guard fleet, they are still working on the same questions: "What are the true costs of the marine services? What is the proper allocation to commercial users? What's the required level of service and what's the appropriate service level?" (Mr. Wayne Smith, Vice-President/General Manager, Seaway Marine Transport, Canadian Shipowners Association)

What are the true costs of the marine services? What is the proper allocation to commercial users? What's the required level of service and what's the appropriate service level?

Wayne Smith, Vice-President/General Manager, Seaway Marine Transport, Canadian Shipowners Association

Other complaints include:

- Fishing, commercial and pleasure shipping were all supposed to pay cost recovery. Five years later, only commercial shipping is paying.

- Impact assessments have been ignored. According to Mr. Smith, "In a letter I received from the principal consultant (of a 1996 Coast Guard study), after the fee was implemented, he said, 'I cannot agree with the assertion of Mr. Thomas' — who was then the Commissioner of Coast Guard — 'that the marine industry can absorb the costs.' ..." He concluded "I can certainly see a significant cargo loss in sensitive cargoes ... at this fee level."

- Dredging services, the first thing to be privatized, continue to escalate in cost. Service fees pay for the Coast Guard's oversight of this privatized service. Dredging fees, said Mr. Adams: "came off of our bottom line and we did pass that on to the commercial sector. But you're talking between $3 million and $4 million. We're not talking phenomenal amounts of money, but that's what it is in the St. Lawrence."

- The Coast Guard has failed to take advantage of technological advances, only marginally cutting the number of its buoys (which it charges for) when Global Positioning Satellites are used by all. Mr. Adams told the Committee: "We continue to try to come up with more effective ways of providing aids in the water that will be more cost effective. But our large aids, you're absolutely right, they're extremely expensive. But they have to be extremely capable because of our weather patterns and the ice, etc., etc. But we will continue to work with industry to reduce those costs."

We continue to try to come up with more effective ways of providing aids in the water that will be more cost effective. But our large aids, you're absolutely right, they're extremely expensive.

John Adams, Commissioner, Canadian Coast Guard, Department of Fisheries and Oceans

- The Coast Guard's costing practices are not clear.

The Coast Guard is not equipped to develop fees or administer fees.

Wayne Smith

Industry also complains that in Eastern Canada, shipowners are administering fees because the Coast Guard bureaucracy is a mess, and paying $2 million for the privilege. Further, according to Mr. Smith, "The Coast Guard is not equipped to develop fees or administer fees. Really, Canada now has a patchwork system, with different regional fees, with different fees for domestic ships and foreign ships. It was a mess from the beginning. Industry worked very hard to rationalize these fees but the Coast Guard just said, you know, this is it. This is the fee."

Example: Icebreaking Fees

Icebreaking fees present a good example of a flawed user charge. For a user charge not to be a tax, it must be linked to the cost of the service. However, icebreaking fees are paid whether the service is being used or not. For example, boats in Lake Superior must pay this fee even though there are no Canadian icebreakers operating in Lake Superior. Ports with no icebreaking needs must pay this fee.

We have the ridiculous outcome that a Canadian icebreaker can provide service to a U.S. ship carrying U.S. cargo, competing with Canadian ships and Canadian cargoes, free of charge. But if we're assisted in ice conditions by a U.S. icebreaker and carrying Canadian cargo, trying to compete in the U.S. market, we are charged by the Canadian Coast Guard whether there are ice conditions in place or whether it's a U.S. icebreaker or even a private icebreaker.

Wayne Smith

According to Mr. Smith, and echoed by other marine-shipping voices, "With the Coast Guard layering on a Canadian icebreaking fee we have the ridiculous outcome that a Canadian icebreaker can provide service to a U.S. ship carrying U.S. cargo, competing with Canadian ships and Canadian cargoes, free of charge. But, as is often the case, if we're assisted in ice conditions by a U.S. icebreaker and carrying Canadian cargo, trying to compete in the U.S. market, we are charged by the Canadian Coast Guard whether there are ice conditions in place or whether it's a U.S. icebreaker or even a private icebreaker."

In general, MSFs affecting navigation are economically questionable, as anyone sailing up the St. Lawrence benefits from these services, and only those stopping at a port must pay.

In the absence of an independent appeal mechanism and review process, such fees are hard to challenge and change.

EFFECTS ON INDUSTRY

Of all the industries from which this Committee heard, marine shippers were the only ones to call for the outright elimination of user charges. This is because of the high cost they can have on their businesses. Industry representatives contended that these can have significant long-term effects on competitiveness. In iron ore, shipping costs make up 25% of the final price. Since Canadian iron ore has an ore grade only half of the major countries in the world, these are very important.

Ports are also affected. Competing against other ports and waterways, such as the Mississippi, which have no charges, narrows the margin. According to M. Ross Gaudreault (President, Société du port de Québec), "We are operating in a very competitive business. ... So when my customer tells me I'm too expensive they don't have to come in Canada. They don't have to use the St. Lawrence River. ..."

We are operating in a very competitive business. ... So when my customer tells me I'm too expensive they don't have to come in Canada. They don't have to use the St. Lawrence River.

Ross Gaudreault,
président,
Société du port de Québec

"Are we really that broke in Canada that we can't afford to dredge the St. Lawrence River, one of the most important waterways in the world, which brings billions of dollars in economic downfall to Canada? We are broke in Canada. It's incredible that we can't afford to dredge the St. Lawrence River. *Ça ne se peut pas*."

The Committee also heard that MSFs could mean the difference between ports like Quebec City being able to attract the booming cruise-ship industry. It was estimated that a ship cruising out of Quebec City twice a week could generate $140 million for the economy. "The new ships have to find a niche. If they don't, it's too costly to come into the St. Lawrence, they position these ships in the Mediterranean. ... We have one of the most beautiful cities in the world, and (at the moment) they come into the St. Lawrence. But if we're too costly, we're not going to get part of it." (Mr. Gaudreault)

Marine groups also contend that insofar as cost recovery was supposed to impose discipline through fees that take into account business impacts and the actual cost of services, it has been a failure. And with the large impact on industry, which business impact analyses are supposed to cover, fees should be eliminated.

RECOMMENDATIONS

Recommendation 1:

The Committee is concerned that the upcoming Treasury Board review of cost recovery, while dealing with important questions of implementation, will not be sufficiently broad in scope. Therefore, the Committee recommends that a Committee of Parliament conduct a government-wide study of the Cost Recovery and User Charge Policy to evaluate both its benefits and costs. This should serve as the basis of any policy reform.

Recommendation 2:

That information on user charges be made easily available to all interested parties. It should include the formula used to determine the user charge, an indication as to whether it is a mandatory charge, whether it is a business charge, the amount of revenue it generates, and the performance promised by each user-charge program. The estimated public/private benefit split should be included, as well as its justification.

Recommendation 3:

Fee revenues should be published annually, with the publication of the budget.

Recommendation 4:

More central guidance is needed in the implementation of the Cost Recovery and Charging Policy. Specifically, stricter guidelines for determining public/private benefits should be put in place. This will help assure that programs with user charges are not starved of general tax revenues, which represent the public investment in this activity.

Recommendation 5:

Uniform standards should be established by Treasury Board to be applied by all departments and agencies. Deviations from those standards must be justified by the departments and agencies.

Recommendation 6:

An open, clear and independent appeal process for those affected by user charges is essential to the well-functioning of any cost-recovery policy. Thus, the Committee calls on the government to create an explicit appeal process and to set up a third-party Ombudsman to deal with user-charge complaints.

Recommendation 7:

Since user charges are similar to taxes, greater scrutiny is required. This cannot be left to individual government agencies. All new user charges, and changes to user charges, should therefore be subject to scrutiny by a parliamentary committee and adopted only if approved by the committee. This would aid accountability and assure that only appropriate fees are implemented. Parliament should also re-examine existing charges to ensure that they are well designed and well implemented.

Recommendation 8:

The Committee recommends that Treasury Board state explicitly what is required in business impact assessments and verify that they are being conducted by the departments. Wherever possible, international comparisons should be made.

Recommendation 9:

The Committee recommends that the government-wide review of user charges examine (1) how well user charges approximate efficient pricing; and (2) whether cost recovery has resulted in underfunding (from general revenues) of cost-recovery sections and overfunding of others. It should

address such issues as mandatory user charges, performance standards and the treatment of public/private benefits with the goal of making the Policy more explicit in its requirements. More specific and enforceable guidelines should be developed to aid in the determination of pricing for voluntary and mandatory services.

Recommendation 10:

Where possible, fees should be reduced if service commitments are not met.

Recommendation 11:

Other enforcement mechanisms should also be considered such as alternative service providers and the use of international standards. Governments have reformed their approach to regulation by replacing some command and control regulations with market-based regulations.

Recommendation 12:

That the government set up a red-tape commission in order to evaluate and streamline regulations. It would conduct an examination of existing regulations to determine if they are still appropriate. Those that are not would be re-written, or deleted entirely. Further, the commission would establish guidelines for the implementation of future regulations. It would be guided by the goal of reducing the regulatory burden on the Canadian economy.

APPENDIX A
LIST OF WITNESSES

Organizations and Individuals	Date
Agriculture and Agri-Food Canada Andrew Graham Assistant Deputy Minister, Corporate Services Branch Jean Chartier Vice-President, Public and Regulatory Affairs Canadian Food Inspection Agency Reg Gosselin Director, Corporate Services Division, Canadian Grain Commission	Tuesday, May 30, 2000
Alliance of Manufacturers & Exporters Canada Jayson Myers Senior Vice-President and Chief Economist Co-Chair, Business Coalition on Cost Recovery Doug Blair President, RIAS Inc. Jean Szkotnicki President, Canadian Animal Health Institute; Co-Chair, Business Coalition on Cost Recovery Garth Whyte Senior Vice-President, National Affairs Canadian Federation of Independent Business	Tuesday, May 9, 2000
BASF Canada Inc. Terry J. Hanson Business Director, Agriculture Products	Tuesday, May 30, 2000
Bayer Canada Inc. Don Wilson Director, Technical Services, Regulatory Affairs	Tuesday, May 30, 2000

Organizations and Individuals	Date
Canada's Research-Based Pharmaceutical Companies John Stewart Executive Vice-President and General Manager Purdue Pharma Marc Desmarais Vice-President, Federal Government Affairs Rx&D Arvind Mani Director, Regulatory Affairs, Rx&D	Wednesday, May 10, 2000
Canadian Animal Health Institute Jean Szkotnicki President	Tuesday, May 30, 2000
Canadian Drug Manufacturers Association Jim Keon President John Hems Director, Regulatory Affairs, Apotex Kent Major Director, Regulatory Affairs and Clinical Research, Technilab	Wednesday, May 10, 2000
Canadian Federation of Independent Business Garth Whyte Senior Vice-President, National Affairs Rob Meijer Policy Analyst, Agri-Business	Tuesday, May 30, 2000
Canadian Shipowners Association Wayne Smith Vice-President/General Manager, Seaway Marine Transport	Wednesday, May 31, 2000
Chamber of Maritime Commerce Guy Dufresne Chair, Quebec Cartier Mining	Wednesday, May 31, 2000

Organizations and Individuals	Date
Consumers' Association of Canada Gail Lacombe President & Chief Executive Officer Jennifer Hillard Vice-President, Issues and Policy Jean Jones Chair, National Health Council	Tuesday, June 6, 2000
Crop Protection Institute Charles D. Milne Vice-President, Government Affairs	Tuesday, May 30, 2000
Department of Fisheries and Oceans — Canadian Coast Guard John Adams Commissioner Tim Meisner Director, Policy and Legislation, Marine Programs Division	Tuesday, June 6, 2000
Health Canada Dann Michols Director General, Therapeutic Products Programme, Health Protection Branch	Wednesday, May 10, 2000
Office of the Auditor General of Canada L. Denis Desautels Auditor General Neil Maxwell Principal, Audit Operations	Tuesday, May 30, 2000
Shipping Federation of Canada Paul Gourdeau Vice-President, Fednay Limited	Wednesday, May 31, 2000

Organizations and Individuals	Date
SODES (St.Lawrence Economic Development Council) Ross Gaudreault President, Quebec Port Authority Marc Gagnon Director General	Wednesday, May 31, 2000
St. Lawrence Shipoperators' Association Ernest Beaupertuis Senior Superintendent, Algoma Tankers	Wednesday, May 31, 2000
Treasury Board Secretariat Richard J. Neville Deputy Comptroller General Rodney Monette Assistant Secretary, Assistant Comptroller General Len Endemann Director, Cost Recovery	Tuesday, May 9, 2000
Treasury Board Secretariat Richard J. Neville Deputy Comptroller General Len Endemann Director, Cost Recovery	Tuesday, June 6, 2000
University of Toronto Richard Bird Professor, Faculty of Management	Tuesday, June 6, 2000

APPENDIX B
LIST OF BRIEFS

Agriculture and Agri-Food Canada

Alliance of Manufacturers & Exporters Canada

Bayer Canada Inc.

Bird, Richard

Canada's Research-Based Pharmaceutical Companies

Canadian Animal Health Institute

Canadian Drug Manufacturers Association

Canadian Federation of Independent Business

Chamber of Maritime Commerce

Consumers' Association of Canada

Crop Protection Institute

Department of Fisheries and Oceans — Canadian Coast Guard

Office of the Auditor General of Canada

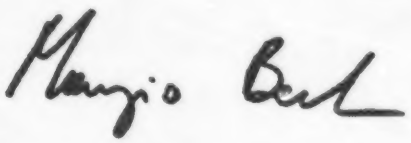
Treasury Board Secretariat

REQUEST FOR GOVERNMENT RESPONSE

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report within one hundred and fifty (150) days.

Copies of the relevant Minutes of Proceedings *(Meeting Nos. 54, 56, 69, 72, 75, 78 and 79 which includes this Report)* are tabled.

Respectfully submitted,



Maurizio Bevilacqua, MP
Chair

Supplementary Report of the Canadian Alliance

The Official Opposition agrees with the report of the Standing Committee on Finance coming from its study on cost recovery. The study and the subsequent report were the result of an initiative by the Official Opposition Finance team comprised of Ken Epp, Paul Forseth, Dick Harris, Gary Lunn, and Monte Solberg. In fact Opposition Finance Critic and Member of Parliament for Medicine Hat, Monte Solberg, tabled Private Members' bills in the House of Commons in 1996, 1997, and 1999 to address the concerns of ranchers and farmers in his riding as well as business people across the country who are faced with paying these charges. All too frequently, representatives from agriculture and industry raised the frustrations they faced trying to comply with usurious federal user fees and a cumbersome cost-recovery policy. As a starting point to undertaking the recommendations contained in the report, the Canadian Alliance would encourage government officials, business leaders, and members of the public to review the Private Members' Bill mentioned above and outlined below.

Entitled, "An act to provide for Parliamentary scrutiny and approval of user fees set by federal authority and to require public disclosure of the amount collected as user fees," the Bill would require scrutiny by the appropriate standing committee of the House of Commons before any user fee may be set or increased. The regulating authority must submit a proposal to the committee before any user fee is established or increased. The enactment would also require the Public Accounts and other government documents that identify sources of revenue to identify the amount of revenue obtained from user fees.

Since Canadian businesses already operate in a high tax environment compared to our major trading partners, it is essential we develop policies which will give Canadian industry an edge rather than penalize them with unfair and unreasonable fees. It is imperative that government operate efficiently in order that taxes and user fees can be lowered significantly to allow the private sector to generate prosperity for all Canadians.

MINUTES OF PROCEEDINGS

Tuesday, June 13, 2000
(Meeting No. 79)

The Standing Committee on Finance met *in camera* at 11:15 a.m. this day, in Room 536, Wellington Building, the Chair, Maurizio Bevilacqua, presiding.

Members of the Committee present: Maurizio Bevilacqua, Scott Brison, Ken Epp, Roger Gallaway, Albina Guarnieri, Sophia Leung, Richard Marceau, The Hon. Lorne Nystrom, Gary Pillitteri, Karen Redman and Paul Szabo.

Acting Members present: Paul Forseth for Monte Solberg, Gerry Byrne for Roy Cullen and David Pratt for Nick Discepola.

In attendance: From the Library of Parliament: Jean Soucy and Blayne Haggart, Researchers; Marion Wrobel, Senior Analyst.

Pursuant to Standing Order 108(2), the Committee resumed its study on Cost Recovery. *(See Minutes of Proceedings of Tuesday, May 2, 2000, Meeting No. 54).*

The Committee proceeded to consider a draft report.

Debate arose thereon.

It was agreed, — That Recommendation 1 be amended in the second sentence to read: "Therefore, the Committee recommends that a Committee of Parliament conduct a government-wide study of the Cost Recovery and User Charge Policy to evaluate both its benefits and costs. This should serve as the basis of any policy reform."

It was agreed, — That Recommendation 11 be amended by deleting the last two sentences.

It was agreed, — That Recommendation 10 be amended in the first line by deleting the words: "and where desirable".

It was agreed, — That paragraph 135 in the draft report be replaced by the following:

"As this Committee has already noted, this kind of openness, clarity and responsiveness is what it has found to be lacking in the implementation of user charges in Canada. Further, in keeping with this Report's recommendations, the government should consider implementing a "regulatory budget," which would detail estimates of the total cost of regulation, including enforcement and compliance costs, and a risk-benefit analysis, as was suggested by the Finance Committee in 1993. An examination of Canada's regulatory structure would help determine whether Canada's previous attempts at implementing sound regulatory policy have been successful."

It was agreed, — That the following new paragraph be inserted after paragraph 75 of the draft report:

"The Canadian Federation of Independent Business (CFIB) pointed out to the Committee that one of the elements to be considered in determining the impact of cost recovery is the issue of productivity. In fact, cost recovery is perceived as a major impediment to improving small business productivity. More than one out of four CFIB members identified this issue as a priority to improve their firm's productivity."

It was agreed, — That Recommendation 8 be amended by adding at the end the following new sentence. "Wherever possible, international comparisons should be made."

It was agreed, — That the draft report, as amended, be adopted as the Ninth Report of the Committee.

It was agreed, — That the title of the Report be: *Challenge for Change: A Study on Cost Recovery.*

It was agreed, — That the Committee append to its report supplementary opinions from the opposition parties provided that they be no more than 3 pages in length (font = 12; line spacing = 1.5) and submitted to the clerk in both official languages no later than 5:00 o'clock, p.m., Wednesday, June 14, 2000.

It was agreed, — That, pursuant to Standing Order 109, the Committee request that the government table a comprehensive response to this report within one hundred and fifty (150) days.

It was agreed, — That the Chair, researchers and clerk be authorized to make such typographical and editorial changes as may be necessary without changing the substance of the report.

It was agreed, — That the Chair be instructed to present the Ninth Report of the Committee to the House.

It was agreed, — That the Committee print 2500 copies of the report in English and 550 copies in French, with a distinctive cover.

At 12:03 p.m., the Committee adjourned to the call of the Chair.

Pat Steenberg
Clerk of the Committee